

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

The District Director will indicate in the block below the kind of claim filed, and fill in, where required, the certificate on the back of this form.

- ☐ REFUND OF TAXES ILLEGALLY, ERRONEOUSLY, OR EXCESSIVELY COLLECTED.
☐ REFUND OF AMOUNT PAID FOR STAMPS UNUSED, OR USED IN ERROR OR EXCESS.
☐ ABATEMENT OF TAX ASSESSED (not applicable to estate, gift, or income taxes).

DISTRICT DIRECTOR'S STAMP
(Date received)

Name of taxpayer or purchaser of stamps **Massey Motors, Inc.**

Street address **830 Main Street**

TYPE
OR
PRINT

City, postal zone number, and State **Jacksonville, Florida**

Florida

1. District in which return (if any) was filed **Jan. 1, 1951 to Dec. 31, 1951**
2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from **Jan. 1, 1951 to Dec. 31, 1951**
3. Kind of tax **corporate income tax** dates of payment **10-22-54 and 10-27-54**
4. Amount of assessment, \$ **5,684.86**
5. Date stamps were purchased from the Government **10-22-54 and 10-27-54**
6. Amount to be refunded **\$ 5,684.86**
7. Amount to be abated (not applicable to income, estate, or gift taxes) **\$ - - - -**

The claimant believes that this claim should be allowed for the following reasons:

See attached Statement of Reasons For Allowance of Claim.

(Attach letter-size sheets if space is not sufficient)
I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

MASSEY MOTORS, INC.
Signed **s/ W. W. Massey, Sr.**
Its President

Dated **November 29, 1954**

(SEE INSTRUCTIONS ON OTHER SIDE)

EXHIBIT "B"

LIBRARY
SUPREME COURT. U. S.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1959

No. 141

MASSEY MOTORS, INC., PETITIONER,

vs.

UNITED STATES OF AMERICA.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 24, 1959
CERTIORARI GRANTED OCTOBER 12, 1959

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IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF FLORIDA,
JACKSONVILLE DIVISION

MASSEY MOTORS, INC.,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant

Civil Action No. 3346-Civil-J

FILED JACKSONVILLE, FLA., JANUARY 17, 1956

JULIAN A. BLAKE, Clerk

COMPLAINT

Comes now the Plaintiff, Massey Motors, Inc., by its undersigned attorneys and complains of the United States of America and alleges as follows:

FIRST CAUSE OF ACTION

1.

Jurisdiction of this action is conferred by Section 1346(a)(1) of Title 28, United States Code as amended.

2.

Plaintiff is a corporation organized and existing under and

by virtue of the laws of the State of Florida with principal office at 830 Main Street, Jacksonville, Duval County, Florida.

This action is one to recover a corporate income tax and interest thereon erroneously or illegally assessed and collected without authority under the Internal Revenue Laws of the United States, pursuant to the authority conferred to sue under Section 1346(a)(1) of Title 20, United States Code, as amended.

That on or about March 15, 1951, Plaintiff filed with and in the office of the then Collector of Internal Revenue for the District of Florida at Jacksonville, Florida, its corporate income tax return Form 1120 for the calendar year 1950 and duly paid to the said Collector, the corporate income tax shown on said return to be due and owing by the Plaintiff to the United States Government; that on or about October 20, 1954, the Commissioner of Internal Revenue assessed additional corporate income tax and interest against the Plaintiff as follows: Income tax in the amount of \$3,012.99 and interest thereon in the amount of \$650.27; that this additional income tax and accrued interest thereon were paid by the Plaintiff to the United States Government on the dates of October 20 and 27, 1954, in the aggregate amount of \$3,663.26. The said additional tax and interest thereon were erroneously or illegally assessed, imposed upon and collected from the Plaintiff, the reason for and basis of such allegation being set forth in detail in Claim Form 843, filed with the Commissioner of Internal Revenue, a true copy of which is hereto attached, marked Exhibit "A" and hereby made a part of this complaint.

3

5.

That on February 3, 1955, Plaintiff filed a claim for refund in the amount of \$3,663.26, plus interest, of the tax and interest paid for the calendar year 1950. A true copy of said claim is hereto attached, marked Exhibit "A", and heretofore by reference made a part of this Complaint.

6.

That said claim for refund was rejected by action of the Commissioner of Internal Revenue by letter dated July 18, 1955.

SECOND CAUSE OF ACTION

1.

The allegations contained in paragraphs 1, 2 and 3 of the First Cause of Action are hereby incorporated by reference.

2.

That on or about March 15, 1952, Plaintiff filed with and in the office of the then Collector of Internal Revenue for the District of Florida at Jacksonville, Florida its corporate income tax return Form 1120 for the calendar year 1951 and duly paid to the said Collector the corporate income tax shown on said return to be due and owing by the Plaintiff to the United States Government; and that on or about October 20, 1954, the Commissioner of Internal Revenue assessed additional income tax and interest thereon against the Plaintiff as follows: Income tax in the amount of \$4,918.46 and accrued interest in the amount of \$766.40; that this additional tax and accrued interest thereon were paid by the Plaintiff on

October 20 and 27, 1954 in the aggregate amount of \$5,684.86. The said additional tax and interest thereon were erroneously or illegally assessed, imposed upon and collected from the Plaintiff, the reason for and basis of such allegation being set forth in detail in Claim Form 843, filed with the Commissioner of Internal Revenue, a true copy of which is hereto attached, marked Exhibit "B", and hereby made a part of this Complaint.

3.

That on February 3, 1955, Plaintiff filed a claim for refund in the amount of \$5,684.86, plus interest, of the tax and interest paid for the calendar year 1951, a true copy of said claim and the statement attached thereto is hereto attached, marked Exhibit "B", and heretofore by reference made a part of this Complaint.

4.

That said claim for refund was rejected by action of the Commissioner of Internal Revenue by letter dated July 18, 1955.

WHEREFORE, Plaintiff prays that a judgment may be entered in favor of the Plaintiff against the Defendant as follows:

1. In the First Cause of Action in the amount of \$3,663.26, plus interest thereon and costs of this suit and for such other relief as to the Court may seem proper and;

2. In the Second Cause of Action in the amount of \$5,684.86, plus interest allowed by law, together with costs and

such other relief as to the Court may seem proper.

JOHN A. RUSH

Florida Theatre Building
Jacksonville, Florida

HILL AND FRAZIER

WILLIAM R. FRAZIER

818 Atlantic Bank Building
Jacksonville, Florida

ATTORNEYS FOR PLAINTIFF

CLAIM

TO BE FILED WITH THE DISTRICT DIRECTOR WHERE ASSESSMENT WAS MADE OR TAX PAID

The District Director will indicate in the block below the kind of claim filed, and fill in, where required, the certificate on the back of this form.

- ☐ REFUND OF TAXES ILLEGALLY, ERRONEOUSLY, OR EXCESSIVELY COLLECTED.
- ☐ REFUND OF AMOUNT PAID FOR STAMPS UNUSED, OR USED IN ERROR OR EXCESS.
- ☐ ABATEMENT OF TAX ASSESSED (not applicable to estate, gift, or income taxes).

DISTRICT DIRECTOR'S STAMP
(Date received)

Name of taxpayer or purchaser of stamps **Massey Motors, Inc.**

TYPE
OR
PRINT

Street address **630 Main Street**

City, postal zone number, and State **Jacksonville 2, Florida**

- District in which return (if any) was filed **Florida**
- Period (if for tax reported on annual basis, prepare separate form for each taxable year) from **Jan. 1, 1950 to Dec. 31, 1950**
- Kind of tax **corporation income tax**
- Amount of assessment, \$ **3,663.26** dates of payment **10-22-54 and 10-27-54**
- Date stamps were purchased from the Government **3,663.26**
- Amount to be refunded
- Amount to be abated (not applicable to income, estate, or gift taxes)

The claimant believes that this claim should be allowed for the following reasons:

An agent of the Internal Revenue Service in auditing the above-named taxpayer's 1950 corporate income and excess profits tax return, filed a report covering his examination dated April 10, 1953, pursuant to which the Commissioner assessed a deficiency against the taxpayer for 1950 of \$3,012.99 with interest thereon of \$650.27. The Commissioner determined that the taxpayer was not entitled to depreciation on (1) automobiles leased by taxpayer to its subsidiary, Atlantic Discount Company, Inc., (2) automobiles used by various Company personnel, and (3) a demonstrator in the amount of \$9,346.69 as claimed on the taxpayer's 1950 return; and the Commissioner further determined that the taxpayer was not entitled to long term capital gains treatment on gains realized from the sale of said automobiles in the amount of \$16,960.21. As a basis of the within claim, the taxpayer contends that it is entitled to a reasonable allowance for depreciation as claimed on the aforementioned automobiles, constituting property used in its trade or business, under Section 23(1) of the Internal Revenue Code of 1939; and that the gain realized by it on the sale of said automobiles is reportable as long term capital gain pursuant to the provisions of Section 117(a) and 117(j) of the Internal Revenue Code of 1939.

WHEREFORE, the taxpayer respectfully demands refund of said deficiency and interest, plus interest thereon as allowed by law.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

MASSEY MOTORS, INC.

Signed **S. W. W. Massey, Sr.**
Its President

Dated **November 29, 1954**

(SEE INSTRUCTIONS ON OTHER SIDE)

EXHIBIT "A"

**STATEMENT OF REASONS FOR ALLOWANCE
OF CLAIM**

An agent of the Internal Revenue Service in auditing the above-named taxpayer's 1951 corporate income and excess profits tax return, filed a report covering his examination dated April 10, 1953, pursuant to which the Commissioner assessed a deficiency against the taxpayer for 1951 of \$4,918.46, with interest thereon of \$766.40. The Commissioner determined that the taxpayer was not entitled to depreciation on (1) automobiles leased by taxpayer to its subsidiary, Atlantic Discount Company, Inc., (2) and on automobiles used by various Company personnel in the amount of \$11,572.45 as claimed on the taxpayer's 1951 return; the Commissioner also determined that the amount of \$2,177.54 excluded from income by the taxpayer during 1951 as a reserve for repossessions is includible as income for the period ended December 31, 1951; and the Commissioner further determined that the taxpayer was not entitled to long term capital gains treatment on gains realized from the sale of said automobiles in the amount of \$13,686.38. As a basis of the within claim, the taxpayer contends that it is entitled to a reasonable allowance for depreciation as claimed on the aforementioned automobiles, constituting property used in its trade or business, under Section 23(1) of the Internal Revenue Code of 1939; that the reserve for repossession set up by it for 1951 of \$2,177.54 was reasonable in amount and legally excludable from taxable income for the period ended December 31, 1951; and that the gains realized by it on the sale of said automobiles is reportable as long term capital gain pursuant to the provisions of Section 117(a) and 117(j) of the Internal Revenue Code of 1939.

WHEREFORE, the taxpayer respectfully demands refund

of said deficiency and interest, plus interest thereon as allowed by law.

No. 3346-Civil-J

FILED JACKSONVILLE, FLA., MARCH 16, 1956

JULIAN A. BLAKE, Clerk

**STIPULATION EXTENDING TIME FOR
DEFENDANT TO PLEAD**

IT IS STIPULATED AND AGREED by and between the undersigned attorneys for the respective parties to this cause that the defendant, United States of America, shall have an extension of fifteen days from March 16, 1956, within which to plead to the complaint herein.

Dated at Jacksonville, Florida, March 16th, 1956.

HILL AND FRAZIER

By WILLIAM R. FRAZIER

Attorneys for Plaintiff

801 Atlantic National Bank Bldg.

Jacksonville, Florida

JAMES L. GUILMARTIN

United States Attorney

By EDITH HOUSE

Assistant United States Attorney

Attorneys for Defendant

407 Post Office Building

(P. O. Box 59)

Jacksonville 1, Florida

CIVIL ACTION NO. 3346

FILED JACKSONVILLE, FLA., MARCH 19, 1956

JULIAN A. BLAKE, Clerk

ANSWER

Comes now the United States by its attorney, James L. Guilmartin, United States Attorney for the Southern District of Florida and answers the allegations of the complaint, as follows:

FIRST CAUSE OF ACTION

1. The allegations of paragraph numbered 1 are admitted.
2. The allegations of paragraph numbered 2 are admitted.
3. The allegations of paragraph numbered 3 are admitted, except it is denied that the corporate income tax and interest thereon was without authority, erroneously or illegally assessed and collected.
4. The allegations of paragraph numbered 4 are admitted, except it is not intended to admit any of the allegations contained in plaintiff's Exhibit "A" not expressly admitted elsewhere in this answer; but it is denied that the corporate tax and interest thereon was erroneously or illegally assessed, imposed upon or collected from the plaintiff and that plaintiff filed its corporate income tax Form 1120 for the calendar year 1950 on or about March 15, 1951. Defendant alleges that on March 12, 1951 plaintiff filed a tentative income tax Form 1120 with the Collector of Internal Revenue for the District of Florida requesting an extension of time to May 15, 1951, which was granted, and plaintiff thereafter filed its income

tax Form 1120 on May 12, 1951.

5. The allegations of paragraph numbered 5 are admitted, except it is not intended to admit any of the allegations contained in plaintiff's Exhibit "A" not expressly admitted elsewhere in this answer.

6. The allegations of paragraph numbered 6 are admitted.

SECOND CAUSE OF ACTION

1. The allegations of paragraph numbered 1 are admitted, except it is denied that the corporate income tax and interest thereon was without authority, erroneously or illegally assessed and collected.

2. The allegations of paragraph numbered 2 are admitted, except it is not intended to admit any of the allegations contained in plaintiff's Exhibit "B" not expressly admitted elsewhere in this answer; but it is denied that the corporate tax and interest thereon was erroneously and illegally assessed, imposed upon or collected from plaintiff.

3. The allegations of paragraph numbered 3 are admitted, except it is not intended to admit any of the allegations contained in Plaintiff's Exhibit "B" not expressly admitted elsewhere in this answer.

4. The allegations of paragraph numbered 4 are admitted.

WHEREFORE, the defendant respectfully demands that judgment be entered in its favor with respect to the first and

second cause of action, with allowable costs.

JAMES L. GUILMARTIN

United States Attorney

By: **EDITH HOUSE**

Asst. United States Attorney

I CERTIFY that on this date a copy of the foregoing Answer of the United States was furnished by mail to Hill and Frazier, Attorneys for Plaintiff, at their last known mailing address, namely, 801 Atlantic National Bank Bldg., Jacksonville, Florida.

Dated at Jacksonville, Florida, March 19, 1956.

EDITH HOUSE

Assistant United States Attorney

IN THE UNITED STATES DISTRICT COURT
IN AND FOR THE SOUTHERN DISTRICT
OF FLORIDA.
JACKSONVILLE DIVISION.

MASSEY MOTORS, INC.,

Plaintiff,

-vs-

No. 3346-Civil-J

UNITED STATES OF AMERICA,

Defendant.

TRANSCRIPT OF PROCEEDINGS

*Before the Honorable Bryan Simpson, Judge of
the above Court, without a Jury in the trial of
said cause, held February 20 and 21, 1957.*

APPEARANCES:

Hill and Frazier, Esqs.,

By: William R. Frazier, Esq.,

John A. Rush, Esquire,

of Counsel,

Attorneys for the Plaintiff.

Jerome S. Hertz, Esquire,

Department of Justice, Tax Division,

Attorney for the Defendant.

INDEX TO WITNESSES

<i>For the Plaintiff:</i>	<i>Direct</i>	<i>Cross</i>	<i>Redirect</i>	<i>Recross</i>
Parks, Henry Edward	5-32	32-66	66-69 71-72	69
Lumpkins, Howard Lewis	74-84			

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MR. MADSEN: Your Honor, I would like to introduce Mr. Jerome S. Hertz. He is from the Department of Justice, Tax Division, and a member of the Bar of the District of Columbia. He will try the case --

THE COURT: He will try the case for the United States. We are glad to have you with us.

MR. HERTZ: Thank you.

THE COURT: You may proceed, Mr. Frazier.

(OPENING STATEMENT BY MR. FRAZIER)

MR. FRAZIER: Before we actually start the case, Your Honor, there are several exhibits we would like to introduce at this time.

The first exhibit is Plaintiff's Exhibit Number 1 and is the Corporation Income Tax Return of Massey Motors, Inc. for the year 1950; and a similar exhibit for the taxable year 1951.

THE COURT: Received as Exhibits 1 and 2.

The foregoing documents were received in evidence and marked Plaintiff's Exhibits #1 and #2.

MR. FRAZIER: And Government counsel will, of course request permission to withdraw the originals and substitute photostats.

THE COURT: He can do that at any time after the trial is over by substituting photostats and giving the

Clerk a receipt.

MR. FRAZIER: Next, Your Honor, Plaintiff offers, as Plaintiff's Exhibit Number 3, a Schedule with respect to the taxable year 1950, which shows practically all the financial data with respect to the Company cars; and a similar Schedule for the taxable year 1951 as Plaintiff's Exhibit 4.

THE COURT: You are familiar with these are you?

MR. HERTZ: Yes, Your Honor. Those are from the Internal Revenue files. I would like to request permission to have some photostats made, because they are reduced in size almost to illegibility.

THE COURT: You are going to try to make some larger ones?

MR. HERTZ: Yes, Your Honor, at least this size.

THE COURT: Certainly, immediately after trial or as soon as I can get through with it, you can have them back.

MR. HERTZ: I would like to be permitted to use them in connection with the cross examination of the witnesses.

THE COURT: Sure. They are in evidence. I understand that.

The foregoing documents were received in evidence and marked Plaintiff's Exhibit #3 and #4.

MR. FRAZIER: And lastly, Your Honor, Plaintiff offers a photostatic copy of the original thirty-day letter involved in this proceeding for the tax years 1950 and '51, as Plaintiff's Exhibit number 5.

THE COURT: That's received without objection.

The foregoing document was received in evidence and marked Plaintiff's Exhibit #5.

(OPENING STATEMENT BY MR. HERTZ)

HENRY EDWARD PARKS,

having been produced and first duly sworn as a witness on behalf of the Plaintiff, testified as follows:

DIRECT EXAMINATION

BY MR. FRAZIER:

Q What is your profession or occupation?

A General Manager of Massey Motors, Incorporated.

THE COURT: What is his name for the record?

Q Give us your full name, please, sir?

A Henry Edward Parks.

Q And you reside here in Jacksonville?

A Right.

Q How long have you been employed as General Manager of Massey Motors, Inc.?

A 1949.

Q And did you hold that position during the two years involved in this suit?

A I did.

Q Are you an officer of the corporation?

A Yes, sir, I am.

Q What office do you hold?

A Secretary.

Q Are you a director?

A No, I am not.

Q Are you a stockholder?

A No.

Q Now, this Massey Motors, Incorporated, is that a Florida corporation?

A Yes, it is.

Q And what is its business?

A A franchised automobile dealership.

Q A franchise by whom?

A Chrysler Corporation.

Q And what type of Chrysler dealer is it? What kind of car --

A Handling-- during the period of this case, 1950 and 1951-- Dodge and Plymouth passenger cars, Dodge gytrated trucks and used vehicles.

Q And what is the approximate trade area served by this corporation Massey Motors, Inc.?

A Uh-- Duval County, Clay County, Baker County, Nassau County; and in the State of Georgia, Camden County and Charlton County.

Q Now, did Massey Motors, Inc. during the years involved in this suit have any other relationship with the Chrysler Corporation, other than being its retail Dodge and Plymouth dealer here?

A Yes. We were known as a direct dealer, or distributorship.

Q Explain what sort of arrangement that was?

A In such an arrangement a direct dealer will assign associate dealers in the counties in which his sales area is located, and in turn-- the direct dealer will buy his merchandise from the factory and will in turn sell to the associate dealers.

Q And how many associate dealers did you have, if you remember, during 1950-'51?

A During the period covered, three.

Q Where were they located?

A Located in Green Cove Springs, Florida; Kingsland, Georgia; Macclenny, Florida.

Q Could you state a little more in detail what the relationship was between Massey Motors and the associate dealers?

A Yes, I can. The associate dealers in buying all of their merchandise from us had no direct relationship with Chrysler Corporation. Chrysler Corporation did not have the authority to even call on an associate dealer without a member of the direct dealership being in company with him, and we helped them with their organization in sales work, not only with automobiles but in parts as well.

Q Well, would it be a correct description then to say that you in effect were substituting as the manufacturer, as far as those associate dealers were concerned, in helping them?

A Yes.

Q Supervising their operations?

A That's right.

Q How many employees did Massey Motors have during these two years, do you know?

A It varied from about 85 to about 120 during the period covered.

Q And how about the place of business of Massey Motors; where was it located during this period we have involved here?

A Actually several locations. Our main place of business and offices were maintained at 830 Main Street; our service building housing our parts department, service facilities and body shop was at 35 West State Street; a used car location at 36 West State Street; a used car location at 1248 Main Street; warehouse facilities located at 8941 Main Street Road; a used car lot located at 2131 West Beaver Street. That was a parent corporation, I might add.

Q How about the subsidiary?

A Subsidiary corporation, Atlantic Motor Sales. They were located on the South Side of the River at 1524 San Marco Boulevard. They also maintained a used car lot in the twenty-hundred block of Beaver Street-- West Beaver Street-- and a used car lot on Miami Road, on the South Side of the River.

Q What was the business of the subsidiary?

A The subsidiary corporation was also a direct dealership with Chrysler Corporation.

Q It was a new car sales concern?

A Handling the same products.

Q Now, Mr. Parks, in the operation of the new car sales operation, and for that matter the used car sales operation, what is the practice, or was the practice, of Massey Motors during these years with respect to driving the automobiles around town if it would help sales to its customers? Would you drive the new cars, or --

A No, that isn't a practice there at all.

Q Well, explain that, please.

A We in no case drove new vehicles that were placed up on the market for sale to retail customers on the street. We did have cars which we termed company-owned vehicles. Do you want me to go into detail with you on that?

Q No. I was just wondering about that. How about used cars? Did you drive them around? The ones that would help the sales of new cars?

A No, we did not.

Q Now, with respect to those-- whatever you might refer as inventory, new or used cars, if you will. Was it a practice during those years to title those cars in the name of the sales corporation?

A New cars that were taken out of our new car inventory and placed in company service --

Q No. I am referring now to the cars that you had for sale to the public?

A No; they were not titled.

Q How about the used cars held for sale?

A Used cars held for sale to the public, as a general-- well, were always titled when they came to us.

Q In the previous owner's name?

A That's correct.

THE COURT: In blank. He'd just sign that thing in blank there and you'd hold it until you sold it?

THE WITNESS: That's correct.

THE COURT: And then let the new owner-- put the new owner's name on it and send it to Tallahassee for re-title?

THE WITNESS: That's correct; yes, sir.

BY MR. FRAZIER:

Q Now, Mr. Parks, are you familiar with the accounting system employed by Massey Motors, Inc. during those two years?

A Yes, sir, I am.

Q Will you please explain, in a general way, how the accounting records of the plaintiff corporation reflect the purchase of new cars? How do you make the entries when you buy cars from Chrysler?

A When we purchase cars from Chrysler Corporation, in our particular case we have made arrangements by agreement with our-- with the finance company that we were doing business with-- whereby Chrysler Corporation would draft on the finance company for the purchase price of the automobiles at the time they left the factory. We, in turn, were invoiced by the corporation and paid the finance company immediately on receipt of that invoice for those automobiles. Those automobiles, when they were paid for by us as the dealer, were placed in our New Vehicle Inventory Account for sale to the general public. That account number, I believe, was Account Number 131.

Q Is that in your journal or in your ledger?

A Yes, it's in my general ledger.

Q I see. And you mentioned previously that a certain number of these cars were withdrawn for company cars. Would you explain what the company cars were, now?

A The company cars, when they were removed from the New Vehicle Inventory, were entered through our sales journal as a direct sale to the corporation. They were removed from the inventory Account Number 131, which was new vehicles for sale to the general public, and placed in our new car-- or, rather, company car account, which was Account Number 167.

Q What is the classification, accountingwise, of that account?

A What do you mean?

Q Is it a fixed asset account?

A Yes.

Q And then what happened?

A Those cars were immediately set up over a period of thirty-six months for depreciation purposes, and at the end of each month they were depreciated. And they were taken in on a cost basis.

Q And what was the accounting procedure if one of those cars was sold and removed from company service?

A Well, when a car was removed from company service and sold, of course it was immediately removed from the New Vehicle Inventory and your proper accounting procedure followed; and in the case of a capital gain or a capital loss, it was so designated on the books.

Q Well, did any of the company cars-- was there an accounting procedure which ever removed the company cars from the fixed asset account back to the new car inventory?

A No, never. That would be impossible because a new car inventory account carries only cars that have never been titled. And these cars we are talking of were titled in the name of Massey Motors.

Q I see. Now, what was the accounting procedure with respect to the leased vehicles?

A Leased vehicles were handled in identically the same manner, titles and all.

Q I wonder at that point if you would explain what this leasing arrangement was, if you know, during these two years?

A The leasing arrangement was with Atlantic Discount Company, Incorporated and it was a verbal agreement whereby we would furnish them automobiles for use by their adjusters, office managers, and so forth, at the rate of three cents per mile return, which was payable monthly. And those cars were called back in at the end of a twelve-month period, or at 40,000 miles, which ever occurred first.

Q Then they were disposed of by Massey Motors?

A That is correct.

Q Now, in the operation of Massey Motors, Inc., who made the decision to place a car in company use or in lease use? How is that handled?

A That was always made by top management.

Q And as I understand your previous testimony, when those cars were put in that service they were titled; is that correct?

A That is correct.

Q Now, by titling, what do you mean?

A Registered with the State of Florida.

Q Showing Massey Motors as the owner?

A Showing Massey Motors as the owner; yes.

Q Now, with respect to that situation, were these automobiles insured against public liability and property damage in any way?

A Cars placed in company service, yes, were insured by a blanket policy which we carried. However, by an agreement we had with the finance company, they provided coverage on the cars they were using.

Q Is that the Atlantic Discount Company?

A That is correct.

Q That was on the leased vehicles?

A That was on the leased vehicles.

Q I see. And what type of Florida license plates were placed on these company cars and leased vehicles?

A A regular license tag, not a "for hire" tag.

Q Now, do you all ever use a so-called "dealer" tag?

A Yes, we do.

Q What are dealer tags?

A Dealer tags are tags that are made available to automobile dealers by the State of Florida. Our State law says that no vehicle shall be operated on the highways without a current year license tag on it, and on occasion we would sell automobiles, we'll say, on Saturday afternoon. The license bureau would be closed. It was necessary to place a dealer tag on that car so that the new owner could operate it until a tag could be purchased in his name.

THE COURT: That's the only thing you used a shop tag for in your operations?

THE WITNESS: Yes, sir. They were not used on any company --

THE COURT: Not used on the new cars, the demonstrators, or anything of that sort?

THE WITNESS: No, sir.

BY MR. FRAZIER:

Q Now, in that connection, Mr. Parks, we inject the word

"demonstrator." Now, did Massey Motors have any demonstrators, as you understand that term?

A Actually, no. Now, there is one unit listed on the schedule which I furnished Internal Revenue whereby I listed a demonstrator.

Q Let's get that. It might be well enough at this point to go into that subject. I hand you Plaintiff's Exhibit Number 3, which is the Schedule of company car accounting data for the year 1950. (Handing document to witness)

A (Witness examining document)

Q Will you explain what the situation was with respect to that truck, or whatever it is that you were going into?

A Yes. The first item listed on this covers a 1949 Dodge Route Van. I might say here that route van was a new type of truck being introduced on to the market, in that it had a motor and drive shaft mounted to the far left side of the frame. It did not go down to the center. The cab came out practically to the bumper in front on the right. It was a low, underslung unit which was designed for department stores and for low-loading business houses. It was something that was so completely new that we found it necessary to put one of these units in service and place it with various business houses so that they could see that it would operate, because nothing like it had ever been introduced on the market before.

Q I see. Did you have any other similar type vehicles in these two years?

A No, we did not. This was the only one.

Q I see. Now, Mr. Parks, I am also going to give you Plaintiff's Exhibit Number 4, which is a similar schedule for the calendar year 1951, and I ask you to hold them there so that you can refer to them if you like-- (Handing document to witness)

A Surely.

Q -- and I will ask, Mr. Parks, if you could enumerate for us from your recollection of the situation as the General Manager of this corporation, just what the company cars were used for? Just as specifically as you can during the two years we have in suit?

A Yes. The various officials of the parent corporation, plus the managers of their subsidiary corporation, in the general course of everyday business in traveling to and from the various locations, these cars were necessary. They were also necessary in making bank deposits, messenger service, well, coming to the post office, for loaning to customers-- quite frequently you have a doctor or someone like that that cannot be without an automobile; you will let him have one of the company official's cars to tide him over. In some cases- at one time in 1951, or '50 rather, we had a strike with Chrysler Corporation that lasted a hundred days. During that time we had several good customers who had total losses with their automobiles and it was necessary for us to put a car out. We also use the cars in contacting our associate dealerships and helping them run their business; for use in various civic functions, such as parades, and so forth. And, I believe in the years involved, we had factory meetings in Atlanta, Georgia, at Tampa, Florida, and at one time we had a special school over at the University of Florida which was sponsored by Chrysler Corporation. We had to have men there for a six-week period, daily.

Q What connection would a company car have with that?

A Furnishing transportation to and from.

Q That included going to Atlanta?

A Yes.

Q And Tampa?

A Yes. Those were new car showings, factory-called meetings.

Q And as I understand, that-- that is in general-- applies to all of the cars designated company cars; is that correct?

A Yes, it would.

Q Well now, Mr. Parks, I notice-- I have a photostat of that exhibit and I notice that, of course, there are sales of these so-called company cars and for the leased vehicles during both of these years; in fact, there are quite a few of them. I wonder if you would tell us what happened to prompt the management to sell these cars, take them out of company use or lease use? What was the situation?

A Well, during the years involved, the economic conditions were such that factory production was not as high, nothing compared with what it is today. On some occasions due to a very good customer being without transportation in a case of total loss, we did agree to pull a company-owned automobile out and sell one. In other cases, we --

Q Well, let's say except for those exceptional cases, what was the general practice about keeping these cars in service?

A The general practice was to pull them out either immediately before or as soon after a model change as possible.

Q Why was that done?

A Well, we felt it was good for business to have our automobiles, company-owned equipment, of the current-year model because that's what we were representing to the public.

Q Was this another factor which would have caused the sale of these vehicles as a general matter?

A Yes, it would because, when the new model comes out, the past-year model immediately drops in value if you hold it.

Q In other words, you sold it to get a better recovery on it?

A That is correct.

Q Were there any other factors that entered into the decision besides the matter of model, year, and price decline that would cause the sale of these vehicles? I notice, for example, that on your schedules that some of them were sold during the current model year. Why was that, if there is any reason?

A Yes, for several of the reasons that I gave you there, such as the event of a total loss.

Q Well, you testified with respect to leased vehicles that the company took them back after 40,000 miles. Was there any similar policy with respect to Massey Motors as affecting these company cars?

A Yes, there was.

Q What was that?

A That was on Massey Motors vehicles; 10,000 miles, roughly.

Q Well, let's see if I understand. Suppose, sir, you had a vehicle in service for, say, eight months and if there was no model change but it had 10,000 miles on it-- do I understand that that would be sold at that point? Is that --

A Yes; it would.

Q And why was that practice followed?

A Again, to hold a new automobile longer than that period you go into a declining price.

Q It was a matter of business judgment?

A That's correct, business judgment.

Q Do you know whether that is generally done in the automobile industry, to your knowledge?

A I think that it is.

Q Now, I also notice from the schedules, Plaintiff's Exhibits Numbers 3 and 4, that during these two years there were profits made on the sale of these units after they had been in service, as you testified, with respect to company cars and to some extent the leased vehicles?

A That's correct.

Q All right. Can you explain to us how that was possible since they were, I take it, used cars?

A Well, I think that the economic conditions would be your explanation on that.

Q Explain it a little more specifically

A Well, we can take periods back before the war when that was not the case and we are fast, well, we have reached it again in some instances now.

Q What happens?

A Well, we do not regain the entire cost of the vehicle that was placed in service.

Q But you did in the aggregate with respect to these vehicles?

A Yes, we did.

Q Why was that; do you know?

A Well, I would say it was due to economic conditions.

Q What economic conditions?

THE COURT: The Korean War and then cars were in short supply.

THE WITNESS: That's right.

BY MR. FRAZIER:

Q And the demand was more than the supply?

A That's right.

THE COURT: You could run one for six months or a year and still get more than a new car cost out of it.

THE WITNESS: That's true.

BY MR. FRAZIER:

Q Now, with respect to --

THE COURT: Excuse me. As long as I brought it up, how many cars were involved in each year? How many company cars were kept each year?

MR. HERTZ: Your Honor, I haven't actually counted the ones in the schedules. I would judge that probably about twenty or thirty. Some of the cars are listed on both years, the ones that are carried over, but I counted there were thirty-nine cars leased, of which eight were supplied in a prior year and held over. Thirty-one were supplied during 1950 and '51 and seventeen of the total were carried over into the taxable year '52. The cars which were furnished to various executives totaled thirty-one cars, of which five-- seven having been carried over from the previous period and five from the subsequent period.

MR. FRAZIER: Now, are you reading '50?

MR. HERTZ: '50 and '51. And there were eleven cars furnished which have been taken out, I might mention here, by Mrs. Massey.

THE COURT: In other words, about sixty cars a year.

About half of them were leased to the Atlantic Discount?

MR. HERTZ: Roughly, yes, sir.

THE COURT: In round figures.

BY MR. FRAZIER:

Q Mr. Parks, I hand you a paper here and just ask you to state generally what it is, without going into details? (Handing document to witness)

A (Witness examining document) It's a breakdown showing the gross profits by departments for the years 1950 and '51, and also the total number of units sold during 1950 and 1951 of Massey Motors and Atlantic Motor Sales.

Q Is that new and used cars?

A Yes.

Q And did you prepare that or was it prepared under your supervision?

A It was. I prepared it.

Q And from what source did you take it?

A From the general ledger; general records of the corporation.

Q Do you have that record with you now, the original of that record?

A Yes, I do.

MR. FRAZIER: We offer this in evidence as Plaintiff's Exhibit Number 5.

THE CLERK: 6.

MR. HERTZ: Your Honor, I have no objection to the offer being put in evidence as being relevant, but I don't mean to have the Government stipulate that the figures are accurate or that they reflect what is in the ledger. The witness will have to testify to that.

THE COURT: Well, I think he has testified to that and he has the ledger here with him.

MR. HERTZ: Well, we haven't had an opportunity to verify any of these figures.

THE COURT: I realize that. All right, it is received in evidence as Plaintiff's Number 6.

... And thereupon the foregoing document was received in evidence and marked Plaintiff's Exhibit #6.

THE COURT: The ledger is here for your inspection. It's the basis of the offer of the extract.

MR. HERTZ: Yes, sir.

Q Mr. Parks, I hand you now Plaintiff's Exhibit Number 6 and ask you how many new and used cars were sold by this dealership and its subsidiary in 1950 and 1951?

A In 1950, 4,199 units. In 1951, 5,178 units.

Q Now, Mr. Parks, would you explain how and what procedure was followed in selling company used vehicles during these two years when they were withdrawn from service?

A In the majority of cases, in the majority of instances, the cars were sold before they were ever removed from inventory, in that it was not the intent of the corporation to remove the cars and place them out to the general public for sale.

Q When you say they were removed from inventory, what do you mean; with respect to the company cars?

A Removed from inventory with respect to company cars.

Q You mean from the fixed assets account?

A That's correct.

Q Well, explain --

THE COURT: From Account #167.

THE WITNESS: That's right. From Account #167.

BY MR. FRAZIER:

Q Well, explain that a little more. Were they sold at retail, wholesale, or just what --

A They were sold at retail.

Q I see. Were they, most of them, put out on the used car lot, or what was the situation?

A No. As I just stated, in the majority of cases they were

sold before they were removed from Account 167. They were never placed on the used car lot. They were used as a special favor to replace a car, we'll say, that there had been a total loss on.

Q Would that be true of the cars that were due to model changing and mileage?

A Yes.

Q Now, Mr. Parks, were any expenses incurred by Massey Motors, Inc., or the subsidiary corporation, in the operation and maintenance of these company cars and leased cars?

A With respect to the leased cars, the expense of operation, the lessor stood all of that; in the repair --

Q You mean Atlantic Discount Company?

A That's correct.

Q That's the lessee.

A Excuse me, lessee. They were responsible for all repairs and cost of operation, according to the terms of our agreement. With respect to Massey Motors, yes, there was expense involved in the operation of them.

Q Do you know the approximate amount of that? I mean, in 1950 and '51?

A 1950 and 1951 it ranged between five and six thousand dollars each year.

Q Mr. Parks, do you remember by any chance the-- at

least the month that the model change came in in 1950, or the day of the month, if you remember?

A I believe that your 1949 model came out in December of 1949; and then our '50 model came out; I believe it was November of 1950.

THE COURT: Don't they come out in November or December of the year previous to the one they have the date on ?

THE WITNESS: As a general rule. Not always in November or December. We've had them as early as September and October.

THE COURT: In other words, your 1949 model would come out in November or December of 1948, wouldn't it?

THE WITNESS: That's correct.

THE COURT: Rather than in 1949 as you've said.

THE WITNESS: Excuse me, Your Honor.

THE COURT: It wouldn't be --

THE WITNESS: The 1950 model would have come out in December of 1949.

THE COURT: I wanted-- I was sure it was inadvertent when you said that.

THE WITNESS: Yes, sir.

BY MR. FRAZIER:

Q How about the 1950 model?

A The 1950 model would have come out in November-- in December of 1949.

Q And can you tell us now about the succeeding model?

A The 1951 model came out in December of 1950.

Q And do you remember when the 1952 model came out; the month.

A I believe it was in December of 1951.

Q Now, Mr. Parks, are you generally familiar with the issue we have here in 1951 with respect to this repossession reserve as set up on the books of Massey Motors, Inc.?

A Yes.

Q Well, will you explain to us what-- Well, firstly, what connection is there between the Atlantic Discount Company and Massey Motors, Inc.?

A They are two separate corporations neither one holding stock in the other.

Q How about-- Is there any common control among the stockholders, if you know about that?

A Yes.

Q Tell us about that.

A The principal stockholders are-- Mr. Massey has the con-

trolling stock in both corporations.

Q Well, now, did Massey Motors, Inc. do any financing business with Atlantic Discount during the two years involved in the suit?

A Yes, they did.

Q And what kind of arrangement-- Well, you were the Manager during these years, what kind of arrangement existed between these companies?

A As is customary with all automobile dealers that do business with finance companies, in general they usually do the majority of their business with one company. In our particular case it was with Atlantic Discount Company.

Q Was all your business done with Atlantic Discount Company?

A Not 100%, no. In so doing business with a finance company, you have what is called a reserve agreement whereby you in turn sell your paper to the finance company and they, in turn, pay you a percentage or set up a reserve for you; in the event that contract is paid out and there's no default in it, at the end of the contract they pay you.

Q Now, Mr. Parks, explain that a little more specifically as it applied between your dealership and Atlantic Discount. Take a typical car and give us an example, if you will?

A All right. We sell a car to a purchaser on time. We in turn would draft on the finance company, American Discount Company, for the face, or rather the cash price, that we were expecting from the customer, excluding finance and insurance.

charges. The finance company would from the finance and insurance charges set up a reserve which was payable to us when that contract was paid out by that customer.

Q Well, say there was a thousand dollars due Massey Motors, Inc., how much would the finance company present to you under the arrangement that you had with American Discount?

A Under the arrangement that we had, there was always a holdback of 5% of the retail outstanding.

Q So that if it was a thousand dollars, you would get a check for \$950.00; is that correct.

A That's correct.

Q And this 5%, or \$50.00 as an example, that we've been talking about, what would happen to that now on the books of Massey Motors, Inc.? How would you account for that?

A It would be carried as due from finance company.

Q And would it be included in the gross income of your corporation?

A It would be included in the gross income of the corporation; yes.

Q Well, in what point of time, would you say? When it was paid to you or what?

A No. It was taken up on a monthly basis and shown from month to month.

Q Well, all right. Now, Mr. Parks, what about this amount that we have here, this entry involved in this suit? I will hand you Plaintiff's Exhibit Number 5 and direct your attention to page 7 of this exhibit where there's a notation "Repossession Reserve." (Handing document to witness)

A (Witness examining document) That's correct.

Q Now, you are familiar with that transaction involved there?

A Yes, I am.

Q Explain just what that was and how it was done and --

A Well, the reserve of \$2,177.54 which was set up was based on 3% of the \$72,584.95 which was due us from the finance company. That \$72,584.95 was due us only if all the contracts that were in force paid off with no loss. In the event of a loss, we were to pay the loss and therefore the 3%, or \$2,177.54, was set up as a reserve for losses.

Q Now, Mr. Parks, do you have with you in the general ledger the sheet which will show or reflect that transaction in 1951; do you have it with you?

A Yes, I do.

Q You do. Now --

A Reserve was --

Q Speak louder, please. What is that document you have there?

A This is the general ledger of the corporation covering the years 1948 through '51.

Q Now, can you turn and find where the entry of \$2,177.54 was set out?

A Yes, I have it.

MR. FRAZIER: Excuse me just one moment. Your Honor, if agreeable with counsel for respondent, is it agreeable that the witness can read from this general ledger without actually offering it and having it admitted in evidence.

BY MR. FRAZIER:

Q Now, Mr. Parks, what account number are you looking at in the general ledger of Massey Motors, Inc.?

A Account number 153, which is "Amounts Due from Finance Company."

Q Now, Explain what that account is all about and why it is in your books there?

A This account represents a reserve on each transaction which is set up by the finance company and due and payable to us when the contracts are paid out.

Q And do you find this entry of \$2,177.54 appearing on this sheet?

A No, sir. It appears on our Account number 253-A, which is titled "Reserve for Repossessions."

Q And what is that, sir? What are the nature of the entries in that account?

THE COURT: Is it 3-A?

THE WITNESS: Yes, sir; 253-A.

A It is set up as a reserve for repossessions. In the event that none of the contracts pay out, or rather that a contract does not pay out and there is a loss to the finance company, it is deducted from this.

Q Now, Mr. Parks, refer again, if you will, to the general ledger. I take it there is an account-- What was it, 253-A, that you were referring to?

A Yes.

Q Find that if you will, please. Now, if you know, Mr. Parks, the amount shown on December 31st, 1951 on that ledger card, was that sum of money held by the finance company from Massey Motors, Inc.?

A Yes, it was.

Q And that's the account on which this \$2,177.54 entry appears; is that correct?

A That is correct.

MR. FRAZIER: You may examine.

CROSS EXAMINATION

BY MR. HERTZ:

Q Mr. Massey --

A Parks.

Q Mr. Parks, on the sheets that you have before you, do you have any record of the cars which were involved in this proceeding? Is the information apart from the column headings shown on the records of Massey Motors?

A Yes, they are.

Q And are the dates and amounts and so forth substantially correct, to the best of your knowledge?

A Yes, sir, they are.

Q Now, sir, with respect to cars that were taken in-- were acquired from Chrysler Corporation-- did Massey Motors particularly order any cars for the purpose of leasing, or for the purpose of furnishing to executives specific cars?

A Yes, in some instances.

Q And approximately how long does it take to service a car? Put it in condition for use by the user?

A To the general public?

Q Yes.

A Depending on your facilities I would say anywhere from six to eight hours per automobile.

Q Now, sir, if you will refer to those schedules that you have before you, you will notice there is a reference number,

which I may state I have appended to identify these various items. If you will look for the year 1951, item number 107 --

A (Witness complies)

Q On what date was that automobile acquired from Chrysler Corporation?

A That was acquired from Chrysler Corporation on June the 22nd, 1951.

Q And on what day was it furnished to the lessee?

A It was removed from the new car inventory, Account number 131, and furnished to the lessee on July 30, 1951.

Q On July 30th?

A That's correct.

Q I refer to Item number 101 on that schedule. On what date was that acquired from the Chrysler Corporation?

A March 31st, 1951.

Q And on what day was that turned over to lessee?

A May 7th, 1951.

MR. HERTZ: Your Honor, the schedule of leased automobiles which is before me contains other instances of that sort. I won't go-- I have them available but I won't go into it particularly at this point except to ask Mr. Parks:

BY MR. HERTZ:

Q What happened to the cars between the time that they were acquired from General Motors and the time they were turned over to lessee?

A Chrysler Corporation is located in Detroit, Michigan, which is well over a thousand miles from Jacksonville. To transport cars from Detroit to Jacksonville by transport or by train it is necessary that you -- by transport it is grouped in units of four or five, by train by four units. It is not uncommon for a car to come out and to be held in the yard, we'll say, for two or three days awaiting a complete load; in some cases more than that. Then they have to be transported to us and, depending on the mode of transportation, it would take anywhere from, oh, eight to fifteen days to reach us.

Q Now, Mr. Parks, the date shown as date purchased, does that indicate the date on which you received the cars or on which you purchased the cars?

A That is the date of the factory invoice.

Q And say that it may take anywhere from-- how many days?

A Eight to fifteen days before we actually have possession of the car.

Q I refer you to Item numbered 98 for the year 1950-- I'm sorry, the year 1951-- On what date does the record show that was purchased?

A Purchased on April 4, 1951.

Q And on what date was it furnished to lessee?

A April 6, 1951.

Q I refer you to Items numbered 12 and 13.

A Same year?

Q No. I have them numbered consecutively; this would be the year 1950 as a matter of fact.

A I have it.

Q As to those two items, how much of a lapse is there between the date noted for purchase and the date noted for furnishing to the lessee?

A The purchase date on 12 was June 12, 1950; removed on June 12, 1950. 13 was on June 15, 1950 and removed on June 15, 1950.

Q Now, Mr. Parks, if it takes eight days or thereabouts for cars to reach you on the average, what's the explanation for items such as 12, 13 and item 98?

A A direct dealer is not restricted to purchasing all of his automobiles from Chrysler Corporation. He can purchase them from any other direct dealer. It is entirely possible that the units involved were purchased from one of the local dealers, whereby our purchase date and our delivery date could be one and the same.

Q And you make no segregation on your books as to which were purchased from the factory and which are purchased from dealers?

A Only on our, what we call entry journal, which is not technically an official record.

Q Do you know of your own knowledge that any one of these cars, any specific one of the cars, was purchased locally?

A That I couldn't say.

Q Is it a fact, Mr. Parks, that in the case of these leased automobiles the period between the date of purchase and the date of furnishing to the lessee varies all of the way from none to thirty-eight days and back again?

THE COURT: Well, that has been demonstrated.

THE WITNESS: What was the --

MR. HERTZ: Well, he has said that they leave--

THE COURT: That has been demonstrated by your questions. Item 107 showed a thirty-eight-day lapse and these two, 12 and 13, show them on the same date. So that has already been demonstrated.

BY MR. HERTZ:

Q I ask you specifically, Mr. Parks, whether any of those items were held for sale to customers prior to the time they were turned over to the lessee?

A It's entirely possible that they were because all cars that were furnished the lessee were not necessarily ordered out specifically for them. In some cases it was necessary to pull cars from our inventory to furnish-- should they have had an accident, or a car been declared a loss, or should they have

hired a new man to increase their force,-- we didn't sit and hold automobiles in readiness for them to --

Q None of the leased cars-- None of the leased cars were specifically ear-marked from the time of purchase?

A Yes, they were.

THE COURT: Some were and some were not?

THE WITNESS: Yes; some were and some were not.

BY MR. HERTZ:

Q And have you any way of telling from the schedules which you supplied the Internal Revenue Service which were and which were not?

A No, I would not.

Q I refer you to Plaintiff's Exhibit Number 6 about which you were questioned on direct examination. What were the gross sales of Massey Motors during the year 1950?

A \$598,470.18.

Q Do you know what the lease income was for that year?

MR. FRAZIER: Excuse me. That was the gross profits, Your Honor, not the gross sales.

THE WITNESS: Excuse me; it was gross profits.

BY MR. HERTZ:

Q I refer you to Plaintiff's Exhibit Number 1, which was

the tax return for the year 1950. What is the net taxable income shown on that return?

A \$278,197.87.

Q And what was the lease income for that year?

A The income from leases \$5,433.55.

Q Now, on direct examination did I understand you to testify that the leasing arrangement between Massey Motors and Atlantic Discount was a verbal agreement?

A That is correct.

Q To your knowledge, is it a customary practice for people engaged in the leasing business to lease on verbal agreement?

A I would say to my knowledge, yes, because in this case it was done.

Q Apart from this particular case?

A I know of no specific case.

Q Did Massey Motors, to your knowledge, ever lease cars to any one other than Atlantic Discount?

A No, we did not.

Q Do you know, of your own knowledge, when the practice of leasing these cars began?

A Without checking our records, I couldn't say.

Q Do you know whether Massey Motors continues to lease automobiles to Atlantic Discount?

A It was discontinued December 31st, 1956.

Q Now, would you explain to us, Mr. Parks, your duties with the Massey Motors company?

A Yes. I am General Manager of the corporation and, as such, have supervision over all departments.

Q And are you also in a supervisory capacity of the various locations maintained by the company through the City?

A Yes. Not with respect to the subsidiary corporation.

Q No, but with respect to the other used car lots?

A That is correct.

Q Are you also connected in a supervisory capacity, in an advisory capacity, with these dealers to whom you refer?

A Yes, in that a direct dealership does.

Q Is it a fact, Mr. Parks, that Massey Motors maintains certain vehicles apart from those which we are concerned with here which were denominated on the books as being for purposes of emergency service, parts deliveries, and so forth?

A We maintained the usual service vehicles such as wreckers, a service truck, a parts truck, and motorcycles for pickup and delivery service.

Q Were they also used for messenger service?

A We had one that was used for messenger service.

Q To your knowledge how many vehicles were held by Massey Motors during these years?

A I couldn't say without counting.

Q Now, sir, in the performance of your duties with Massey Motors company, is it your testimony that you require the services of an automobile; the use of an automobile?

A That is correct.

Q And is it also your testimony that in accordance with the practice you mentioned on direct examination it is customary for the company to dispose of company cars after they have traveled approximately ten thousand miles?

A That is correct.

Q I refer you to the schedules you have before you and I want to ask you about specific cars as having been furnished for your use.

A Might I state at this point that, since this is a consolidated return, it also contains the cars that were used by the General Manager of the subsidiary corporation, and without checking exactly I cannot specify that I used this one or that one.

Q Well, we will find that out for your memory as to particular items.

A Yes, surely.

Q Now, I call your attention to item 64. What kind of automobile was that?

A Item 64 was not used by me.

THE COURT: Well, that isn't the question he asked.

THE WITNESS: I thought he was asking me about the cars that I used personally.

A Item 64 covers a Dodge Coronet Convertible Coupe, 1951 model.

Q You state that car was not used by you?

A No.

Q I refer you to item 4.

A That covers a 1949 Dodge Coronet Town Sedan.

Q And was that car used by you?

A Yes, it was.

Q On what date was it charged on the books for your use?

A October 31st, 1949.

Q And on what date was it disposed of?

A January 17, 1950.

Q During these years, Mr. Parks, did you use any-- to the best of your recollection, did you use any club coupes-- any of the cars listed as General Manager's Club Coupe?

A I truly couldn't say.

Q I am trying to shorten the procedure. As you say, there are some of these cars --

A I have used all models.

Q I refer you to item 54 and ask you whether you used that automobile?

A I couldn't state.

Q Would you check item 56. Can you state whether you used that automobile?

A No, I could not.

Q Item 67?

A Again, I couldn't state on any particular one.

Q Except you do know you used item 4. You know you used item 4 that we are talking about?

A Yes, I did use item 4.

Q What is the average mileage put on to a car that you use, a car such as this that you use, per month, Mr. Parks?

A The average mileage, I would say, would be -- oh, I would say anywhere from 1,500 to -- well, approximately 1,500 miles.

Q Is it likely that 10,000 miles would have been put on a car by yourself in a period of seventy-five or eighty days?

A No, sir, but a model change came in there.

Q Is it your testimony that both yourself and the general manager of Atlantic Motor Sales required the services of an automobile?

A That is correct.

Q Is it not a fact that neither yourself nor the General Manager of Atlantic Motor Sales had a car charged out to him for a period of five months between January 12th, 1950 and June 14th, 1950?

A That I couldn't say without checking the records.

Q If the records so shows, would that be correct?

A That would be correct.

Q Is it your testimony you have use for any one more than one car at any one particular time?

A I, as an individual?

Q That's right.

A No.

Q And if the records show that the General Manager, either yourself or the General Manager of Atlantic Motor Sales, had three cars charged out, either one of you or both of you, for a period of six months, what would be the explanation for that?

A For a period of six months?

Q For a period of six months.

A I would say there must have been a mistake; that would be impossible.

Q Is it your testimony that no individual had more than one car at one time?

A Yes.

Q And if the record shows otherwise, it's a mistake?

A I would say yes, to this extent: That quite frequently an automobile when sold for various reasons may not be billed for several days, such as awaiting the bank or other financing institution to approve credit thereon. In a few cases which we did state, have stated previously, a car was removed from inventory before it was sold to a customer, removed from company service.

THE COURT: Removed from company service?

THE WITNESS: That's right.

BY MR. HERTZ:

Q Apart from these items which are a matter of days, if the record states that more than one car was charged out to any one person at any one time, it is your testimony that the record is incorrect?

A There is a possibility that it is incorrect. To the best of my knowledge, at no time were three units charged out to two general managers except under circumstances that I have described.

Q Would that testimony hold true as to the General Sales Manager, to your knowledge?

A Yes, it should hold true.

Q Now, Mr. Parks, who is it that makes the determination for accounting purposes as to which account these various items will be entered into? Who determines whether a particular car that has been furnished to an individual shall be put in the account as an inventory item or as a company car?

A Follow the procedures outlined by Chrysler Corporation's General Accounting System.

Q Who was it that determined that the cars furnished to Mrs. Massey and Bob Massey for personal use --

MR. FRAZIER: Your Honor, we object.

Q (continuing) -- should be carried in the same fashion as the other cars that are here in suit?

MR. FRAZIER: Your Honor, we object to that on the grounds that it is immaterial and irrelevant. There is no issue with respect to any of the vehicles charged to Mrs. Massey and Bob Massey.

MR. HERTZ: Your Honor, the record shows that these cars were similarly --

THE COURT: They were in the same category until today, weren't they?

MR. HERTZ: Until yesterday.

THE COURT: Until yesterday, or whenever it was. It is certainly within the realm of proper cross examination to say that those were in there with these others and to inquire about them.

A As General Manager, I very possibly did myself.

Q Now you referred on direct examination to the question of insurance on the various automobiles. Did I understand your testimony to be that, apart from the leased cars, there was a blanket insurance policy covering all cars, company as well as the cars that were in new car inventory?

A Yes.

Q Did you have occasion from time to time-- Strike that please. With what insurance company is that policy carried?

A At this time I couldn't tell you without going back and checking our records. We have changed companies several times.

Q To your knowledge was it a company wholly independent of Massey Motors and Mr. Massey?

A Wholly independent, yes.

Q Was it your practice during these years to furnish to the insurance company from time to time any reports as to which cars were held as company cars and which cars were kept in inventory?

A Yes, it was.

Q How often were those reports furnished?

A As I have stated, we have done business with several companies. Some required it; some did not. During these specific years, I couldn't say without checking our records, exactly; but those reports on the uses, where they were required, we were required, when we placed a unit in company use, to so advise them at the time it was placed in.

Q And you do not recall whether that was done for the particular years here in suit?

A No, I don't.

THE COURT: Well, those cars in inventory are just in dead storage awaiting sale?

THE WITNESS: Yes, sir.

THE COURT: And all you would want would be fire and theft?

THE WITNESS: Yes, sir. Actually --

THE COURT: You would have to carry liability insurance on those so-called company cars, wouldn't you?

THE WITNESS: Yes, sir. But actually there is such a policy that covers me, as a principal of the corporation, regardless of whether I get into a new car that is for sale to a customer or a used car or a company-designated car. That is the type we now carry and I don't know whether it's a type that we were carrying at that time or not.

MR. HERTZ: Well, Your Honor --

THE COURT: Excuse me. Let me finish. Certainly

the company carrying the risk-- the insurance company carrying the risk-- would be interested in the number of cars that were out running up and down the highway and subjecting them to risk under their policy; risk of loss under their policy, as opposed to the ones that were sitting up in dead storage and in a fireproof building where there is not much chance of anything happening to them. They would be bound to. It would affect your rate, is what I am getting at; the number that you had in dead storage, the number that you had-- the company cars, the executive cars, whatever you want to call them.

THE WITNESS: With reference to public liability and property damage, yes, sir. On fire and theft-- rather, public liability and property damage, yes.

THE COURT: Even though it's a blanket policy, there has to be some basis to decide what the rate is.

THE WITNESS: Yes, sir. On fire and theft, we do have a monthly reporting form on that.

BY MR. HERTZ:

Q But there is no separate insurance policy for any of the company cars, is that true, apart from the general blanket policy?

A That's correct.

Q To your knowledge during the years here in issue, what was the approximate gross profit margin on an automobile? For example, if a car cost the company \$1,956.00 on paper, what is that car supposed to sell for?

A I could just give you a guess or an estimate. The Chrysler Corporation has advocated in their retail price structure a 25% mark up. Not all dealers conform to that because it is a suggested mark up. You take today, for instance, no dealer receives the full retail price, or the suggested retail price, by the factory. He discounts his merchandise below that.

Q In the schedule which we have before us, in the column headed "Sale Price", does that represent the manufacturer's suggested resale or does it represent cash value of what you got, or what?

A It represents the sale price that was placed on the merchandise by us.

Q And are there any instances, to your knowledge, in that schedule where there was a practice of so-called trading along on company cars, allowing over-allowances on trade-ins?

A I wouldn't deny, in a number of cases, yes.

Q Now, in such a case, would the figure shown for sale price represent cash plus the actual value of the car received, or the cash plus the allowance made on the trade-in?

A Well, this figure would represent both.

Q For example, if an executive car was sold for \$2,000.00 at a stated price --

MR. FRAZIER: Your Honor, we object. There is no dispute in this proceeding as to what we got for the cars. It is stipulated in the exhibit what we got for them. In the Revenue Agent's report there is no mention at all of any adjustment, or what we did or didn't get for the

cars. For that reason we think it's objectionable and improper and it is irrelevant testimony.

THE COURT: The objection is overruled.

A Will you state the question again?

THE REPORTER: "For example, if an executive car was sold for \$2,000.00 --"

Q -- and you received, let us say, \$1,000.00 in cash and a used car on which you had placed a value of \$1,000.00 for purposes of trade in, which was in fact worth, let us say \$700.00, would the price received be stated as \$1,000.00 plus \$1,000.00 or \$1,000.00 plus \$700.00?

A \$1,000.00 plus \$1,000.00.

Q Plus \$1,000.00?

A That's correct.

Q And was the car taken in trade written down immediately on the books of Massey Motors?

A No. The cars taken in trade were taken into used car inventory at the same value at which they were traded for.

Q To your knowledge, Mr. Parks, do each of the individuals, company individuals, who are listed as having received cars during these years have full-time use for one car?

A I would say yes.

Q Does your wife own an automobile?

A Yes, she does.

Q It's a part from the one --

A Yes, it is.

Q Do you drive to and from work in the car which Massey Motors has made available to you?

A Yes. I am on call twenty-four hours a day.

Q To your knowledge is that true with respect to the other executives of Massey Motors company?

A I would say any executive would be on call twenty-four hours a day.

Q Now, I would like for you to refer back to that schedule--before that I would like to ask you whether it was the practice of Massey Motors to furnish a car at all times to Mrs. Massey?

A Whether or not it was a practice?

Q Yes.

A I would say, according to the records here, yes; she was furnished a car.

Q And if the records show, Mr. Parks, that for a period of several months Mr. Massey was charged with two cars and Mrs. Massey was charged with no cars, what would the explanation be for that, as far as you know?

A Well, just speaking from my own personal experience,

I can't recall any time that Mrs. Massey has been without a personal automobile.

Q And you are not able to explain why the record should show any such thing?

A No.

Q To your knowledge was more than one car at a time ever furnished for Mrs. Massey's use?

A To my knowledge, no.

Q And you would have no way of explaining it if she happened to have more than one car charged out to her at any time?

A Well, yes. On one or two occasions, I think. In one year in question, I don't remember whether it was '50 or '51, we were experimenting with an automobile on interiors, on rebuilding them. And we took the automobile that she was going to use and used it and consequently it would have been held out, and there is a possibility that during that time two cars would have been assigned to her.

Q What kind of car was that you were experimenting with?

A Just a regular stock automobile. We were experimenting with the interior. The interiors to us-- we didn't think the factory had finished them off quite the way they should. In fact, we converted a number of them.

Q Did Massey Motors maintain a truck franchise during these years?

A Yes, we did.

Q And did you have during both of these years an executive known as a New Truck Sales Manager?

A Yes, we did.

Q And did he have use for an automobile?

A He certainly did.

Q Would you have any explanation for the fact that-- If the record shows that he had two cars for three and half months and no cars thereafter, would you have any explanation for that?

A I would say, no cars thereafter. I don't remember whether it was during these two particular years that we abolished the job of the New Car Sales Manager-- I mean the New Truck Sales Manager-- or not. If there was no car thereafter, apparently it was. I mean we did abolish his job.

Q What were the functions of an individual known as the Transport Manager?

A During the first, I believe--the record will verify this, about ten months of 1950, we operated our own fleet of transports in hauling automobiles.

Q And for what period of time did that continue?

A It was either the first nine, or first ten, months of 1950. We didn't haul all of our own merchandise, but as much of it as we could.

Q And did that person have a car at his disposal as long as he was with the company?

A Yes, because we had transport trucks operating between here and Detroit, Michigan, and he was on call all the time.

Q Mr. Parks, which of the individuals classed as executives of Massey Motors are actually engaged in direct selling of cars?

A I would say all officials are engaged indirectly, primarily, I would say, your Sales Managers would be the ones that would be principally actively engaged in selling.

Q To your knowledge, does Mr. Massey engage to any extent in direct selling of cars?

A He's an automobile dealer; yes.

Q On the floor of the --

A He does not compete with the salesmen, if that's what you mean.

Q Is that true as to yourself?

A That's right.

Q Is that true as to the Vice President?

A I would say yes.

Q And the only individual then among the executives that would be engaged in direct selling on any substantial basis is the Sales Manager?

A. Well, all management at one time or another are called on because of friendship or business relations to sell automobiles. There isn't, I don't believe, a month that goes by that I don't sell, yet I don't compete with the salesmen.

Q. Now, who in the general sales force of Massey Motors had authority to show one of these cars, one of these company cars, to a prospective customer?

A. How do you mean who had the authority to show them?

Q. Suppose a man came-- Suppose I came in to Massey Motors during these years and saw a salesman on the floor and I told him, "I am interested in purchasing one of these so-called executive cars." Would the salesman have authority to take me out in back to show me a car that was sitting there, presently charged up as having been used by one of the executives?

A. Well, I would say that any car that was parked on our premises, the customer could look at it.

Q. Did the general salesmen have authority to close the transaction for the sale of such a car?

A. All sales are approved by the top management. A salesman may make a sale on anything he so desires, but the sale is not consummated until completely approved by the house, or top management.

Q. Are the salesmen in any way notified that certain company cars are considered available for sale to the public?

A. There have been times when cars were short in supply.

Q Have you ever personally sold one of the cars charged to you?

A Have I ever personally sold one?

Q Yes, to a general customer?

A My answer would be no.

Q To your knowledge, did Mr. Massey ever sell any of the cars charged to him personally?

A I would say yes.

Q In the case of cars charged to you, who arranged for the sale of those cars?

A It could have been any one of the salesmen or sales manager, or even Mr. Massey.

Q They had authority to show that car and consider it available for sale?

A They had authority to submit the transaction on any automobile in our place.

Q And do you, as General Manager, consider those automobiles available for sale to the public?

A In the general course of business, no.

Q You say they were used-- On direct examination you testified these automobiles were used for approximately ten thousand miles?

A Approximately.

Q When an automobile had been used for ten thousand miles, how was it disposed of?

A As a general rule, when a car started to approach the ten thousand mile bracket, the salesmen were so notified that it was going to be available for sale, and if they had any one that was interested in it they might see if they could sell it.

Q Did it ever take, to your knowledge, three years to arrive at a ten thousand mile figure on any of these cars?

A We didn't keep any units except service units for a period of three years.

Q Was it your general experience that these cars were resaleable; the cars furnished to executives?

A Yes.

Q Mr. Parks, let us suppose that a customer comes into Massey Motors and wants to see a particular feature which is not available in the cars held by the salesmen. If such a feature, for example, in this day, power brakes or air conditioning and so forth, is available in one of the company cars, is that shown to the customer?

A Again, I would say that any automobile that would be on the premises, whether it would be mine or even a customer's car, if you came in and wanted to see air conditioning, I would be glad to open the door and show it to you.

Q And would you drive me around the block to see how it felt?

A Well, company cars that are placed in company service are not in the demonstrator class, and all of our salesmen maintain their own demonstrator.

Q I am referring specifically to features not contained in the salesmen's cars.

A I would say on occasion, as you would find with any automobile occasionally, you are going to let someone get in. Any time that I'm out and if you are going with me, I will suggest that you drive my car because I would like for you to see how it operates.

Q Is it not a fact, Mr. Parks, that Chrysler Corporation generally makes available to Massey Motors cars for things like parades?

A They do not.

Q And did not during these years?

A They have never, not to my knowledge.

Q What type of cars are furnished for parades?

A We have used all types; trucks, open cars, closed cars; we recently had some in, I believe, the last parade we had here in Jacksonville that were sedans.

Q And how often are such parades held?

A Periodically, depending on the times.

Q You made reference to a school held at the University of Florida?

A That's correct.

Q Who was required to attend that school?

A Actually it was a school sponsored by Chrysler Corporation.

Q For whom?

A Any authorized mechanic of a dealership, of a Chrysler Corporation dealership, who would pay the enrollment fee could attend.

Q How many people went from Massey Motors?

A We had three men.

Q How many?

A Three.

Q Three men?

A That's correct.

Q How many people normally attend the factory meetings, such as the one you referred to in Atlanta?

A Well, in Atlanta that was the showing of the new model automobiles, and in such a case you always take all of the salesmen that you can, plus your top management, because that is your first view of new model automobiles and they usually indicate what their policies for the year will be.

Q How large is the sales force at Massey Motors?

A At present we have, I would say --

Q During these years? During the years in question.

A It varied during those years. I would say ten to twelve.

THE COURT: That's new and used car salesmen?

THE WITNESS: Yes, sir.

THE COURT: And truck salesmen?

THE WITNESS: It probably would have gone higher than that with the truck salesmen.

BY MR. HERTZ:

Q And did substantially all of these people attend such meeting, the showing of the new models?

A Oh, yes.

Q And that happens once a year?

A Well, yes, in that it's once-- it was once for Dodge; once for Plymouth, and once for Dodge trucks, so you have three such meetings.

Q To your knowledge, does Massey Motors personally warrant the executive cars that are sold with the equivalent of a new car guaranty?

A Yes, I would say we do. We do that with any late current model automobile as a general rule.

Q That includes all of the used cars you have for sale?

A That is correct.

Q And these are not treated any differently?

A No.

Q To your knowledge, Mr. Parks, was Massey Motors at any time during these years itself engaged in the finance business?

A No, we were not.

THE COURT: Suppose we take a few minutes rest break.

... And thereupon a short recess was had at the conclusion of which Court reconvened and the following further proceedings were had:

BY MR. HERTZ:

Q With reference to the cars that were leased to Atlantic Discount Company, is it a fact that Atlantic Discount Company had some of these cars under lease for substantially less than 40,000 miles?

A Twelve months or 40,000 miles, I believe.

Q And substantially less than either?

A In the majority of cases I would say no; not substantially less.

Q And if the record shows such instances do exist, do you have any explanation for it?

A I doubt if you would find but maybe one or two exceptions in two years.

Q We will let the record speak on that point. According to the exhibits you have furnished, the leased cars were carried as having been leased until the very date that they were sold?

A Yes.

Q As a practical matter how was the sale of the leased cars --

A They were sold at retail.

Q Were they shown while still in the possession of Atlantic Discount Company?

A In the majority of cases on the sales of these automobiles this was during a period when cars were still very scarce; there was no trouble to move them at all.

Q Were there occasions when any of these leased cars were surrendered and put on used car lots?

A Maybe for a period of two or three days.

Q Otherwise they were sold right from the possession of Atlantic Discount Company?

A In some instances, yes. The adjusters themselves sold them or bought them.

Q In the case of a general customer that came into Massey Motors and was interested in such a car, was it understood by

the salesmen that they could show those cars?

A They could not. They were not available for sale.

Q Were they then sold sight unseen?

A They were not-- You mean, could the salesman take a customer over to the finance company and show him an adjuster's automobile?

Q Yes.

A No.

Q I would like to clear the matter up, Mr. Parks. The record shows that Atlantic Discount had charged to it a certain car, one of the cars in question, up to a particular date.

A Uh-huh.

Q Now, on a certain date, they were charged as having been sold.

A That's correct.

Q Am I correct in understanding that people don't normally buy used cars without seeing them?

A As I stated, there could have been a lapse in there of two or three, or possibly five, days; but never over ten days did we hold on to those automobiles.

Q Then the cars, as a general practice, were taken back from Atlantic Discount and put on and shown at Massey Motors?

A In many cases, yes.

Q Was that true as to the cars furnished to the executives of Atlantic Discount ?

A As a general rule, no.

Q Are you familiar at all, Mr. Parks, with the rental rates, or leasing rates, for automobiles; commercial-leasing rates on automobiles?

A I am not at present.

Q Did you have any knowledge of it during these years?

A Yes, we did, because we contemplated leasing to several other organizations-- Foremost Dairies for instance.

Q What are the terms on which automobiles were leased in that period?

A Depending entirely on the agreement as to repairs and upkeep and general maintenance, the figure we had arrived at of three cents a mile I believe was being used at that time by one or two of the car rental agencies.

Q Based on 40,000 miles at three cents a mile, the company would realize income, rental income, in the amount of \$1,200.00 during the course of the year on a car; is that correct?

A That's right.

Q To your knowledge, during that year would the depreciation on that car in fact exceed the rental figure?

A Might I add that no two automobiles can you price the same because they never come back in the same condition.

Q I am speaking of depreciation that you charged off on the books on a monthly basis?

A Yes.

Q Did the depreciation on the average car so furnished exceed the amount of the rental?

A No. I believe your rental would run a little more than your depreciation.

Q Would there be any substantial difference between the two figures?

A No, there wouldn't be a great deal.

Q Now, directing your attention for one moment to this matter of a reserve, you were referred to the general ledger accounts. I have one or two questions with respect to that. When was this reserve set up for the first time?

A When we first entered into an agreement with Atlantic Discount Company for them to buy our paper.

Q I am speaking of the \$2,100.00 that is in issue for the year 1951; is there a similar item in the books of the company for the year 1950?

A There is not.

Q There is not. Did the finance company in fact owe money to Massey Motors under a withholding agreement as

of the end of the year 1950?

A Yes.

Q Is there any similar reserve for subsequent years?

A No, there is not, because it was ruled out.

Q I would like to ask you a question with respect to the two accounts that you referred to, the one showing the total --

A Reserve.

Q -- the total amount owed by the finance company to Massey Motors, and the other one the \$2,100.00 item. Is the total amount actually owed by the finance company shown in the larger account? In other words, did they owe you? Would you refer to the exact figure?

A Yes.

Q As of December 31, 1951, what was the total amount withheld by the finance company and forthcoming from Massey Motors?

A The amount at the end of 1951 was \$72,584.95.

Q Now, is the other account that contains the \$2,100.00 item based on a percentage of that figure?

A Yes, it is.

Q The finance company did not owe you \$73,000.00?

A No, they did not.

MR. HERTZ: That's all the questions I have of the witness at this time.

BY THE COURT:

Q Could you say that the \$2,100.00 figure is 3% of the \$72,000.00; is that what that is?

A Yes, sir.

Q \$72,000.00 is 5% of the face amount of discounting contracts? That is in substance correct?

MR. HERTZ: Yes, sir.

A That is correct.

Q And the \$72,000.00 item-- the books were kept on an accrual basis and that was taxes paid on the \$72,000.00?

MR. HERTZ: That was the testimony of the witness. We will try to straighten that out.

REDIRECT EXAMINATION

BY MR. FRAZIER:

Q Mr. Parks, just two or three questions here that relate to some of that cross examination that I want to try and clear up. Firstly, there were several questions asked with reference to the fact that by looking at the exhibits which we have, particularly those two large schedules for 1950 and 1951-- and I think they are Plaintiff's Exhibits 3 and 4-- it appears that possibly more than one automobile was assigned to one particular category of management, or one person?

A Yes.

Q Is that correct?

A Well, I might say --

Q Explain what that situation is. Do you assign more than one car to one individual, for example yourself, at any one time?

A Technically, no. The automobiles are used principally in the operation of the business and there are a few exceptions whereby it was necessary, in one particular case that I recall, to let one of our very good customers have an automobile, I think it was for almost a two-month period. We couldn't put a man out of his automobile in the operation of our business to loan his car out.

Q So you assigned him another one?

A That's correct.

Q So the records would show two cars?

A That's right.

Q Eventually one would be disposed of, I take it?

A That's correct.

Q Now, Mr. Parks, with respect to this leasing: If I recall your other testimony, was this a net lease? Did Atlantic Discount furnish its own maintenance or repairs on these cars?

A They were free to get their maintenance and repairs at

any place they so desired, because they had cars all over the State of Florida.

Q Who paid for that maintenance under the arrangement?

A They paid for the maintenance, themselves.

Q How about the insurance?

A They paid for their own insurance.

Q Who bought their oil and gasoline?

A They did.

Q In other words, it was a net rental?

A That's right.

Q Except for depreciation, did you have any other expense against that rental operation?

A No.

Q Now, Mr. Parks, during the cross examination there was some-- By virtue of the questions propounded to you, there was an implication raised that these company cars-- and for that matter the leased cars-- we are talking about were held principally for sale rather than principally for use in the business. Now, can you explain what was the principal purpose for which these cars were held?

A They were held for the operation of our business as automobile dealers.

Q Let me ask you this. Based on your experience, having managed this business and so forth, do you believe that you could operate a successful retail automobile agency the size of Massey Motors without having these company cars at your disposal?

A No, sir, I could not.

MR. FRAZIER: Thank you. That's all I have.

RECROSS EXAMINATION

BY MR. HERTZ:

Q With respect to the leased cars, your testimony was that you had no expenses. Does that apply to sales expenses, too; sales of the cars?

A Sales expense, yes, would be involved.

THE COURT: I don't understand that.

MR. HERTZ: There was testimony that this was a net rental and Massey Motors had no expenses connected with those leased cars, but they do at least have sales expenses.

THE WITNESS: Operating expenses.

MR. HERTZ: When they dispose of them.

THE COURT: When they take them back and sell them, why, they are paying the salesmen; is that what you mean? Is that what you are talking about?

MR. HERTZ: Yes.

7 THE COURT: I just didn't understand it. They have to sell them when they take them back, is what you are talking about?

MR. HERTZ: According to the records-- according to the books, they were never put back. They were sold right out of the possession of Atlantic Discount. That is what the exhibit furnished to the Government reflects.

THE COURT: I don't know how there would be-- What puzzles me, I don't know how there would be of necessity any bookkeeping operation showing that they took them back. Suppose they did take them back and had them on their lot a couple of days, it would not be reflected in the books unless there was a bookkeeping entry transferring them to their used car inventory, and that was made and then they were sold out of the used car inventory. If they just simply took possession back, why, there would not be necessarily any entry about it, would there?

MR. HERTZ: That would be so, certainly, Your Honor.

THE COURT: I don't think you can, from the books, you can decide whether a car was sold right out from under one of these adjusters or whether the adjuster dropped it by there and they kept it a day or so and sold it. I don't think it's possible to decide that; not in anything that has been suggested so far.

MR. HERTZ: No. And the reason I asked the questions on the book entries was that the only piece of documentary evidence offered by the taxpayer is that exhibit.

THE COURT: Some of them, I guess, as to these executive cars-- Am I correct in this, that some of them would actually be transferred from this executive or company car account to the used car inventory and then sold; was that the case, Mr. Parks?

THE WITNESS: No, sir; we did not.

THE COURT: You did not?

THE WITNESS: No, sir.

THE COURT: You just simply sold them?

THE WITNESS: That's correct.

THE COURT: And transferred the title that had been issued to Massey Motors to the purchaser?

THE WITNESS: That's correct.

MR. HERTZ: The difficulty is, Your Honor, the record shows there is no consistency at all about the period in which any of these cars were leased or company cars; hence the initial questions I asked.

THE COURT: Yes. I realize that that goes to the ultimate bearing on the ultimate question here-- the primary purpose for which they were held. The inconsistencies in all those matters, in fact the very number of them, would go to the purposes for which they were held.

MR. FRAZIER: One other question, Mr. Parks. I want to get that straight. That's a pretty important point.

BY MR. FRAZIER:

Q I believe we went into this on direct examination as to the accounting procedure with respect to company leased cars. If I understand it correctly, the cars were removed by accounting entry from the new car inventory and placed in the fixed assets account; is that true?

A That is correct.

Q And did they not remain there at all times until sold to whoever bought them?

A Yes.

Q They were never retransferred to either the new car or used car inventory?

THE COURT: It is clear now. It is cleared up by my last question.

MR. FRAZIER: Thank you.

BY THE COURT:

Q I am no bookkeeper and I don't understand very much about bookkeeping but I suppose that the fixed assets account, as you call it, it is a capital account?

A Yes, sir.

Q And that the money realized from a car sale would go into that-- would be reflected in that account?

A Yes, sir.

MR. FRAZIER: It would be just like the sale of a typewriter.

THE WITNESS: That's right.

THE COURT: They sell a car, say, for \$3,000.00 to themselves for the use of a man, say Mr. Parks or somebody else, which runs six or eight or ten or twelve months; and maybe they can sell it to the public again for \$3,000.00. That \$3,000.00 goes into that fixed assets account, capital account, there in lieu of the automobile.

MR. HERTZ: It's a double-barreled entry. They have got to get it into the cash account and debit the cash, then they credit the fixed assets account. It is a double-barreled entry to get the depreciation out of the reserve.

THE COURT: I am not going to try to take a course in bookkeeping this afternoon.

MR. HERTZ: Excuse me, Your Honor. There is one thing with reference to that bookkeeping. The money received for company cars being reflected in the asset account. I suggest, Your Honor, that your treatment of the price received on these company cars is not what it would have been in any other business where you were selling a capital asset. They were selling an asset and took a trade-in. The trade-ins were not capital assets, they were to be held for sale; and under the Code it is a sale or exchange of a capital asset for non-similar property. Now, theoretically at least, they should have valued the cash plus the actual fair market value of the car taken in trade and that would have represented presumably a capital loss; and they should have written down on their books the value of the traded-in car, its fair

market value when it was acquired, and showed no later ordinary loss upon the disposition of the used car.

THE COURT: Instead they did it the other way, as I understand it. I gathered that from some of your cross examination.

MR. HERTZ: The difficulty is it represents a substantial difference because the gain that is reported when you take in a more or less paper profit is a capital gain and is taxed at 25% and the loss would come out at 50% of ordinary income. And there is a substantial tax difference.

THE COURT: Yes, sir.

HOWARD LEWIS LUMPKINS,

having been produced and first duly sworn as a witness on behalf of the Plaintiff, testified as follows:

DIRECT EXAMINATION

BY MR. FRAZIER:

Q Would you state your full name for the record, please, sir?

A Howard L. Lumpkins.

THE COURT: What is that surname?

THE WITNESS: Lumpkins.

Q Mr. Lumpkins, what is your trade or occupation?

A I am Secretary and Treasurer of Atlantic Discount Company.

Q How long have you been so engaged?

A Since May of '52.

Q During the years 1950 and 1951 where were you employed?

A I was engaged as Office Manager and Treasurer of Atlantic Motor Sales and Massey Motors.

Q As Office Manager, did you supervise or do part of the bookkeeping for this automobile agency?

A Yes, sir.

Q And from that you are familiar with their books and records in those two years involved in this suit?

A Yes, sir.

Q Now, Mr. Lumpkins, the method by which finance transactions are handled between Atlantic Discount and Massey Motors is familiar to you?

A That is correct.

Q Is there any difference that you know of between the date that you began working at Atlantic Discount and the years involved in this suit?

A They are more or less the same. The percentages or the hold-backs may vary.

Q Now, was there any financial arrangement between the automobile company, Massey Motors, Inc., and Atlantic Discount Company during these years?

A Yes, there was.

Q And you have one now, I take it; is that correct?

A Yes, sir.

Q All right. Now, explain just what that arrangement is and how it operates, if you will, please, sir?

A Now or in '50 or '51?

Q Explain how it operates --

A In general?

Q Yes, in general? If there was any difference in 1950 or 1951 that you know about, tell us about it.

A In the ordinary course of business a customer will purchase a car from Massey Motors. Let's assume that the car sells for \$2,000.00. The customer pays a thousand dollars down and finances \$1,000.00. He signs a contract with Massey Motors for a thousand dollars, plus finance charges and insurance. Massey Motors takes that contract and discounts it or sells it to the Atlantic Discount Company. Out of the finance charge and the insurance charge, there is a certain percentage held back on Massey Motors as dealer's loss reserve. That reserve is not payable to Massey Motors theoretically on each individual account until that particular account is paid in full. On a recourse arrangement you usually use composite amounts, you might say --

Q Just a moment, What's a recourse arrangement?

A A recourse arrangement is where the selling dealer has to repurchase the car in the event of repossession for the unpaid balance from the finance company.

Q Is that arrangement -- Was that arrangement in these years followed between these two companies?

A It was, yes, sir.

Q Now, did you bring with you the original ledger sheets, or subsidiary ledger sheets, of Atlantic Discount Company which show these transactions for 1950 and 1951?

A I have '51.

Q For '51 only?

A Yes, sir.

MR. FRAZIER: Your Honor, we offer as Plaintiff's Exhibit 7 the original ledger sheets of Atlantic Discount Company showing the financial transactions with Massey Motors, Inc. for the year 1951, which is the year we have this matter in question.

MR. HERTZ: Your Honor, I respectfully suggest that the amount shown on Atlantic Discount's books as being due to Massey Motors is not in issue here. The question is what was shown on Massey Motors' books, and we have that in evidence already.

MR. FRAZIER: I want the witness to explain how those transactions are handled.

THE COURT: I don't think it makes any-- it hurts any to have it in evidence. What number are you giving it?

THE CLERK: 7.

The foregoing document was received in evidence and marked Plaintiff's Exhibit #7.

BY MR. FRAZIER:

Q Mr. Lumpkins, handing you back Plaintiff's Exhibit 7, I will ask you to state in general what is shown on those records? What do they purport to reflect? (Handing document to witness)

A (Witness examining document) This reflects the date of each individual transaction purchased from Massey Motors, showing the customer's name-- that is, the customer who purchased the car and financed it-- and the amount of the hold-back on that particular account.

Q What is the balance on that as of the end of the year, December 31st? First, give me the balance on November 30th?

A November 30th, \$72,955.70.

Q And what is it on December 31st?

A \$74,916.12.

Q How was that account reflected on the general ledger of Atlantic Discount Company? What classification?

A It is a liability account on the finance company books.

Q In other words, it represents money due --

A° It represents money due to Massey Motors if each account pays out. It's a continuous idea.

Q I see. And do you have similar arrangements with unrelated dealers, or dealers where there is no continuity of interest?

A° Yes, sir. It's a standard financing agreement.

Q Does it work exactly the same, or substantially the same?

A Yes, sir.

Q° Just forgetting a moment there is any connection between Massey Motors and Atlantic Discount, if a representative of Massey Motors would come into your office and make a demand for that seventy-some-odd-thousand dollars as of December 31st, would he get it?

A No, he wouldn't.

Q When would he get it, if ever?

A We would determine what is payable three times a year, according to our agreement, which is January, July and October. At that time we run an adding machine tape of every account that is purchased from Massey Motors that is still outstanding.

Q Yes, sir.

A We take that total amount, which I believe for instance

in January of 1951 was \$1,200-some-odd-thousand that they were contingently liable to us for; in January of that year we were maintaining a 3% hold-back. We took 3% of the \$1,200,000.00, which would come to approximately what -- \$36,000.00. From that balance on our records on January 31st, which was \$47,000.00, we subtract the \$36,000.00 hold-back and pay them the excess of \$9,808.00. That's done three times a year.

Q I see. Continue, please.

A Now, the \$74,000.00 is reflected at the end of December and a part of that was actually payable to them, but the time of paying it had not arrived.

Q Well, as I understand it then, on December 31st, 1951 an amount equivalent to 3% of the total amount of paper, as we will call it, for which Massey Motors was continually liable, would be held by the --

A At December 31st, it was 5%. The early agreement was changed in July of '51.

Q It would have been 5%?

A It would have been 5% of approximately \$1,300,000.00.

Q And if the balance in that account was in excess of that 5%, it would be remitted to Massey Motors; is that correct?

A That's correct.

Q And the balance would be held?

A Yes, sir.

Q And that's true with other dealers -- other arrangements with other dealers?

A That's right.

Q And did Atlantic Discount handle financing for other dealers, other than Massey Motors, the same way?

A Oh, yes.

Q Now, Mr. Lumpkins, I want you to take the general ledger of Massey Motors, Inc. You were in the Courtroom when Mr. Parks testified about that Account 253?

A Yes, sir.

Q You were the Office Manager during '51 at Massey Motors, weren't you?

A Yes, sir.

Q And you are familiar with those records. Now, explain to us for the benefit of the Court just how this transaction is reflected on Massey Motors' books that we have been talking about?

MR. HERTZ: Your Honor, I don't know whether this is cumulative or whether he is trying to impeach the testimony of his own witness.

THE COURT: I don't know that it has fully been explained by the other witness. He told me that he had a witness that could explain it.

MR. HERTZ: If Your Honor please, the previous wit-

ness testified how much Massey Motors' books showed was due to it. He said that the amount had been returned and the total of the income, and with the exception of the fact that a reserve of 3% of that amount had been set up on the books; and I think that --

THE WITNESS: I think we can say the same thing a little bit more clearly.

MR. FRAZIER: That's what I am trying to do.

THE COURT: The objection is overruled.

A At the end of each month Massey Motors calls Atlantic Discount Company to arrive at the amount of hold-back set up on their books during that particular month.

Q In other words, to verify it with your records; is that it?

A We send them a copy of each particular deal. They know what it is and they verify the amount with our records so we will be in conjunction all the time.

Q You mean in agreement?

A In agreement, right. The bookkeeping entry at that particular time on Massey Motors' books, assuming the reserve or the hold-back was, say \$3,000.00 for the month of January, Massey Motors would debit an asset account called "Due From Finance Companies."

Q Is that an accounts receivable?

A That's an accounts receivable. They would credit a reserve called "Repossession Losses" account, which is a re-

serve account on the liabilities section. Then that is carried along until the end of the year, mainly from a matter of personal preference not to pick up that profit each month; let each month stand on its operational income and not miscellaneous income. On December 31st of each year, that reserve for repossessions-- the amount that has been set up for the entire year-- is taken up in the miscellaneous, or ordinary income, and credited to that charge back out of the reserve account to zero. Now, in the year 1951, 3% of the seventy-two-odd thousand dollars was set up as a reserve.

Q Now, let's get this point straight. On December 31st, 1951 there was some seventy-four thousand dollars in the reserve account; is that right?

A Right.

Q And that represented moneys being held by Atlantic Discount?

A That's right.

Q All right. Now, what happened to the difference between the \$74,000.00 and this \$2,100.00 entry we have been talking about?

A It went into ordinary income.

Q In other words, Massey Motors picked it up as ordinary income; is that correct?

A Correct.

Q And washed this out, in effect, from the reserve account except for the \$2,100.00?

A Except the \$2,100.00. There shouldn't have been any reserve at all. It should have been 3% of their contingent liability of a million, two or three hundred thousand dollars, and not 3% of the possible income that they may receive on it.

Q In other words, it would have been the full \$74,000.00?

A Right. Except, I would say, \$74,000.00, it should have been 3%, or 5%, of the liability. The seventy-four might have been in excess.

Q I see. If the total contingent liability were \$1,000,000.00 at the end of December, they should have kept in the reserve account how much, 5% of that?

A 5% would have been \$50,000.00

Q And the excess over that they would have done what with? Taken it out --

A Taken it up in the income. That's all they were liable for.

MR. FRAZIER: Thank you. That's all I have.

MR. HERTZ: No questions.

THE COURT: Come down.

(witness excused)

MR. FRAZIER: Your Honor, that's all I have.

THE COURT: Has the Government anything?

MR. HERTZ: The Government offers no witnesses.

THE COURT: Do you want to argue this matter this afternoon or not?

MR. HERTZ: I am going to be here at Your Honor's convenience.

THE COURT: You are going to be here in town, and I don't want to keep everybody here late tonight. It is almost five-thirty. I suggest that you gentlemen appear here at ten o'clock in the morning and I will hear the arguments before we start these other two cases. I have two cases still set for tomorrow and we have a matter here of sentence at nine-thirty.

THE MARSHALL: Yes, sir.

... And thereupon Court adjourned to be reconvened at 10:00 o'clock in the forenoon, Thursday, February 21, 1957.

... And at 10.00 o'clock in the forenoon, Thursday, February 21, 1957, Court reconvened pursuant to adjournment of the preceding session and the following further proceedings were had:

THE COURT: Mr. Frazier was about to start his argument yesterday afternoon. Isn't that about where we left off?

MR. FRAZIER: Yes, sir.

(CLOSING ARGUMENT BY MR. FRAZIER)

(CLOSING ARGUMENT BY MR. HERTZ)

(REBUTTAL ARGUMENT BY MR. FRAZIER)

THE COURT: I want an opportunity to examine these exhibits and I think all I want from counsel on either side, if you furnish me with a list of citations of the applicable authorities rather than working up a comparison of the testimony.

MR. HERTZ: In letter form?

THE COURT: It will be all right for each of you to address a letter setting forth the authorities and citations which you rely on.

Thank you, Gentlemen.

And thereupon the trial of this cause was concluded.

CERTIFICATE

I, JOHN A. VIGNEC, Official Reporter, United States District Court, Southern District of Florida, DO HEREBY CERTIFY that I personally recorded, stenographically and by electronic recorder, the foregoing transcript of the proceedings herein set forth; that the same was reduced to type-writing under my supervision, and that the foregoing pages, numbered 1 through 86, inclusive, constitute a true and correct transcript of my shorthand notes.

JOHN A. VIGNEC.

CIVIL ACTION NO. 3346-CIV.-J

FILED JACKSONVILLE, FLA., OCTOBER 7, 1957

JULIAN A. BLAKE, Clerk

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This suit for the recovery of corporate income taxes and interest thereon was tried to the Court without a jury. From the pleadings, exhibit, testimony and argument and memorandum of counsel, the Court makes the following

FINDINGS OF FACT

1. Plaintiff is a corporation organized and existing under and by virtue of the laws of the State of Florida, with principal office at 830 Main Street, Jacksonville, Duval County, Florida.

2. This action is one to recover a corporate income tax and interest thereon erroneously or illegally assessed and collected without authority under the Internal Revenue Laws of the United States, pursuant to the authority conferred to sue under Section 1346(a)(1) of Title 20, United States Code, as amended.

3. That on or about May 12, 1951, Plaintiff filed with and in the office of the then Collector of Internal Revenue for the District of Florida at Jacksonville, Florida, its corporate income tax return Form 1120 for the calendar year 1950 and duly paid to the said Collector, the corporate income tax shown on said return to be due and owing by the Plaintiff to the United States Government; that on or about October 20, 1954, the Commissioner of Internal Revenue assessed additional corporate income tax and interest against the Plaintiff as fol-

lows: Income tax in the amount of \$3,012.99 and interest thereon in the amount of \$650.27; that this additional income tax and accrued interest thereon were paid by the Plaintiff to the United States Government on the dates of October 20 and 27, 1954, in the aggregate amount of \$3,663.26.

4. That on or about March 15, 1952, Plaintiff filed with and in the office of the then Collector of Internal Revenue for the District of Florida at Jacksonville, Florida, its corporate income tax return, form 1120 for the calendar year 1951 and duly paid to the said Collector the corporate income tax shown on said return to be due and owing by the Plaintiff to the United States Government; and that on or about October 20, 1954, the Commissioner of Internal Revenue assessed additional income tax and interest thereon against the Plaintiff as follows: Income tax in the amount of \$4,918.46 and accrued interest in the amount of \$766.40; that this additional tax and accrued interest thereon were paid by the Plaintiff on October 20 and 27, 1954, in the aggregate amount of \$5,684.86.

5. That on February 3, 1955, Plaintiff filed a claim for refund in the amount of \$3,663.26, plus interest, of the tax and interest paid for the calendar year 1950.

6. That on February 3, 1955, Plaintiff filed a claim for refund in the amount of \$5,684.86, plus interest, of the tax and interest paid for the calendar year 1951.

7. The said claims for refund were rejected by action of the Commissioner of Internal Revenue by letter dated July 18, 1955.

8. The Plaintiff during the period herein involved operated under a franchise from Chrysler Corporation for the retail sale of Plymouth and Dodge automobiles and Dodge trucks, and

as a wholesale distributor of these automotive products for Chrysler Corporation in Duval, Clay, Baker and Nassau Counties, Florida, and Camden and Charlton Counties, Georgia, all located in and around the Jacksonville, Florida trade area.

9. The Plaintiff as a distributor for Chrysler Corporation appointed associate dealers in several of the counties included in its sales area. Under this arrangement the Plaintiff purchased all merchandise from Chrysler Corporation, and it in turn sold the same to its associate dealers. During the calendar years 1950 and 1951, the Petitioner had three associate dealers located in Green Cove Springs and MacClenny, Florida, and Kingsland, Georgia.

10. Under Plaintiff's distributorship arrangement, Chrysler Corporation had no authority to sell merchandise directly to an associate dealer, nor did a representative of Chrysler Corporation have authority to call on an associate dealer without a member of the Plaintiff's staff being with him. The Plaintiff as the distributor also helped its associate dealers in sales promotion work in connection with the sale of Chrysler automobiles, trucks and parts. In general, the Plaintiff supervised the operation of its associate dealers in much the same way that Chrysler Corporation supervised and directed its retail dealers.

11. During the years in question, the Plaintiff employed between 85 and 120 persons. The principal office of the Plaintiff was maintained at 830 Main Street, Jacksonville, Florida. Its servicing and parts department and body shop were located at 35 West State Street; the used car lots were located at 36 West State Street, 1248 Main Street, and 2131 West Beaver Street. A warehouse was located at 8941 Main Street, all at Jacksonville, Florida.

12. The Plaintiff owned all of the outstanding stock in a subsidiary corporation known as Atlantic Motor Sales, Inc., located on the South side of the St. Johns River in Jacksonville, Florida, at 1524 San Marco Boulevard. The subsidiary corporation maintained a used car lot in the 2000 block of West Beaver Street and a used car lot on Miami Road, both in Jacksonville, Florida. The subsidiary corporation was also a direct dealer of Chrysler Corporation and handled approximately the same products as those sold by the Plaintiff.

13. For the taxable years involved, Plaintiff and its wholly owned subsidiary, Atlantic Motor Sales, Inc., filed consolidated corporate income and excess profits tax returns.

14. The sources of Plaintiff's income and gross profit of each of its departments for the calendar years 1950 and 1951 were as follows:

MASSEY MOTORS, INC	1950	1951
New Car Department	\$ 527,929.76	\$ 557,699.48
Used Car Department	154,221.60	179,117.47
Stockroom (Parts)	102,318.53	84,681.93
Service	122,443.49	122,383.12
	<hr/>	<hr/>
Total Gross Profit	\$ 598,470.18	\$ 585,647.06

ATLANTIC MOTOR SALES, INC.		
New Car Department	\$ 231,632.17	\$ 310,407.59
Used Car Department	97,936.06	98,347.37
Stockroom (Parts)	18,592.85	22,980.82
Service	23,861.43	37,898.14
	<hr/>	<hr/>
Total Gross Profit	\$ 176,150.39	\$ 272,939.18

15. During 1950, Plaintiff's gross sales were \$6,157,631.03, and in 1951 the gross sales were \$7,601,985.35.

16. During the period here involved, the Plaintiff and its wholly owned subsidiary, Atlantic Motor Sales, Inc. sold new and used cars and trucks as follows:

MASSEY MOTORS, INC.	1950	1951
New Dodge	778	682
New Plymouth	424	428
New Dodge Trucks	373	590
Used Units	1510	1479
Totals	3085	3179

ATLANTIC MOTOR SALES, INC.	1950	1951
New Dodge	280	306
New Plymouth	126	179
New Dodge Trucks	160	370
Used Units	548	1144
Totals	1114	1999

17. New cars held by the Plaintiff for retail sales to customers were not driven at all by the Plaintiff with the exception of driving necessary for the servicing and delivery of these cars to customers. The same was true with respect to used cars and trucks sold by the Plaintiff in the regular course of business.

18. Plaintiff's new cars held for sale in the ordinary course of business were not registered in its name. Likewise, used cars were not registered in the Petitioner's name. Used cars were generally titled or registered in the name of the pre-

vious owner, who upon trading his car would assign his registration certificate in blank. When Plaintiff sold these units, they were re-registered in the name of the new owner by the office of the Florida Motor Vehicle Commissioner.

19. All cars and trucks obtained by Plaintiff from Chrysler Corporation as a matter of original entry are charged into Account No. 131 on its ledger. When cars or trucks are placed in company use, an entry was made whereby the vehicles were removed from Account No. 131 and placed into the company car account which was designated on Plaintiff's accounting system as Account No. 167. Account No. 167 was a fixed asset account.

20. The Plaintiff depreciated its company cars on the straight line method, utilizing an estimated useful life of 36 months, which the Court finds to be a reasonable and fair rate.

21. During 1950, the Plaintiff had 57 company cars in service, of which 23 were leased to Atlantic Discount Company, Inc. (Exhibit 3). During 1950, the Plaintiff sold 31 company cars, 19 of which were held less than six months prior to date of sale and 12 of which were held for more than six months.

22. During 1951, the Plaintiff had 61 company cars in service, of which 26 were leased to Atlantic Discount Company, Inc. (Exhibit 4). Plaintiff sold 28 company cars in 1951, 14 of which were held less than six months prior to the date of sale and 14 were held more than six months.

23. The decision to place cars in company use was made by decision of Plaintiff's top management. As a car was placed

in company use, it was covered with fire, theft, comprehensive, public liability and property damage insurance for the exclusive benefit of the Plaintiff. Regular license plates were procured for each such car in the Plaintiff's name and the automobile was paid for in full in cash. Dealer tags were never used on any cars used for the company business.

24. The record discloses that the company cars in issue were used by the various officials of the Plaintiff and its wholly owned subsidiary, Atlantic Motor Sales, Inc., in the general course of everyday business which included among other things traveling to and from the various locations maintained by both corporations. The cars were also used in making bank deposits, messenger service, trips to the postoffice, and for loan to customers needing transportation. The cars were also used to permit managers and other company personnel to travel for business purposes to cities such as Atlantic, Georgia; and Tampa, Florida, for new car showings and other types of factory meetings. The cars were also used by the Plaintiff in its contact with its associate dealers, and for use in various civic functions, such as, parades, etc. Plaintiff's business could not have been operated without the use of company cars.

The decision to sell the company cars was made by Plaintiff's management on the economic facts of whether holding a car longer would appreciably reduce the sales price for it. The Plaintiff followed the practice of disposing of all company and leased cars either immediately before or as soon after a model change as was practicable. Plaintiff's management deemed it advisable to have company personnel in current model company cars. Plaintiff also disposed of leased vehicles during the year if a particular unit had been run approximately 40,000 miles. Company cars were also removed

from service when they had been run approximately 10,000 miles without regard to model change.

All of the cars in issue upon which long-term capital gains treatment was claimed were held for more than six months, and some were held more than one year.

25. During the period involved, the Plaintiff leased a number of cars to a corporation known as Atlantic Discount Company, Inc. at a net rental of 3c per mile, payable monthly. Atlantic Discount Company, Inc. was in the automobile finance business and the leased cars were used by its company personnel in the operation of this business. In 1950, 26 cars were leased, and in 1951, 23 cars were leased. The Plaintiff received rental income in the respective amounts of \$5,433.55 and \$7,288.22 during 1950 and 1951 from Atlantic Discount Company under the lease arrangement.

26. Atlantic Discount Company, Inc. paid all costs of operating and maintaining the leased vehicles including the cost of all necessary collision and public liability insurance.

27. During 1950 and 1951, Plaintiff incurred expenses of maintaining and operating its company cars of approximately \$5,000 to \$6,000 annually.

28. In his opening statement, counsel for the Plaintiff abandoned any issue with respect to the depreciation and capital gain on the sale of five cars shown on Exhibit 3 as used by Mrs. W. W. Massey, the wife of Plaintiff's president, or Bob Massey, his son, for 1950, and six such cars shown by Exhibit 4 for 1951.

29. In its return for the calendar year 1950, Plaintiff deducted \$9,346.69 as depreciation on all of its company cars.

including those leased to Atlantic Discount Company, Inc. During the calendar year 1950, Plaintiff sold 31 of its company and leased cars, of which 19 were held less than six months. Plaintiff reported a short-term capital gain in the amount of \$10,247.00 with respect thereto. The remaining 12 cars were held more than six months, and Plaintiff reported a long-term capital gain in the amount of \$6,713.21 with respect thereto. In its return for the calendar year 1951, Plaintiff deducted \$11,572.45 as depreciation on its company cars, including those leased to Atlantic Discount Company, Inc. During the calendar year 1951, Plaintiff sold 28 of its company and leased cars, of which 14 were held less than six months. Plaintiff reported a short-term capital gain in the amount of \$6,760.41 with respect thereto. The remaining 14 cars sold were held more than six months, and Plaintiff reported a long-term capital gain in the amount of \$6,925.97 with respect thereto.* All of these cars, with the exception of those mentioned in paragraph 28 above, were used in Plaintiff's trade or business, were not properly includable in Plaintiff's inventory, and were not held primarily for sale in the ordinary course of its trade or business.

30. During the years 1950 and 1951, the Plaintiff had a standard financing agreement with Atlantic Discount Company, Inc., whereby Massey Motors would sign a contract for the sale of a car for a customer desiring to finance a portion of the purchase price in which contract the finance charges were added and insurance costs. The Plaintiff would then assign or discount this contract to Atlantic Discount Company, Inc. The finance company would then remit to the

* In 1951, Plaintiff sold two of its company cars, upon which it reported a long-term capital gain in the aggregate amount of \$2,240.31, which was not contested by the Commissioner thereby leaving 12 cars involved in this case for said year.

Plaintiff its check for the cash price for the automobile as specified in the contract, exclusive of finance and insurance charges. The finance company would set up a reserve from the finance and insurance charges, which was not payable to the Plaintiff until such time as each contract was paid in full by the purchase of the car involved.

31. Under the financing arrangement which Plaintiff had with Atlantic Discount Company during 1951, the finance company held back from the Plaintiff as a dealer reserve 5% of all retail contracts then outstanding.

32. The Plaintiff was also under what is known as a recourse arrangement with Atlantic Discount Company, Inc. as a part of its financing agreement whereby Plaintiff agreed to repurchase any car in the event of its repossession by the finance company for an amount equal to the unpaid balance due from the former owner or purchaser of the car. On the books of the finance company, the so-called holdbacks were shown as an account payable due Plaintiff, and on Plaintiff's books, it was carried as an account receivable from the finance company.

33. Plaintiff kept its books and records and files its corporate income tax returns for the period involved on the accrual basis.

34. Under the financing arrangement, Atlantic Discount Company would account to the Plaintiff at the end of each January, July and October for any portion of the so-called finance holdback which might be due Plaintiff. That is to say if in 1951, the holdback were in excess of 5% of the then total outstanding retail contracts purchased from plaintiff at the accounting date, the excess would be paid to Plaintiff and

the balance remaining in the reserve account would not be payable until each retail contract were paid in full.

35. Under the financing arrangement, Atlantic Discount Company, Inc. had the right to charge any losses on reposessions for which it was not otherwise reimbursed against the moneys held back or so-called dealer reserve.

36. The Plaintiff in filing its tax return for 1951 accrued and carried into ordinary income all of the so-called finance reserve holdback being held by Atlantic Discount Company as of December 31, 1951, in the amount of \$72,584.95, except the sum of \$2,177.54 which had been excluded and charged to an account No. 253-A entitled "reserve for reposessions".

CONCLUSIONS OF LAW

1. The Court has jurisdiction of the parties and subject matter of this action: Title 28, U.S.C., Section 1340; Title 26, U.S.C., Section 3772.

2. The company cars involved in this proceeding, except those assigned to Mrs. W. W. Massey and Bob Massey, as shown by Exhibits 3 and 4, were bona fide used in the operation of Plaintiff's trade or business, were not properly includable in Plaintiff's inventory, and were not held primarily for sale in the ordinary course of its trade or business under the provisions of Section 117(j) of the 1939 Code. See *United States v. Bennett* 186F. 2d 407 (5th Cir. 1951; *Latimer-Looney Chevrolet Company, Inc. v. Commissioner*, 19 T.C. 120 (1952); *Arthur L. Fields v. Granquist*, 134F. Supp. 624 (D.C. Ore. (1955); *W. R. Stephens Co. v. Kelm*, 140F. Supp. 12 (D. C. Minn. 1956).

3. The Plaintiff is entitled to the depreciation claim on its company cars, with the exception of the cars mentioned in paragraph 2 above, in its 1950 and 1951 returns under Section 23(1) of the 1939 Code.

4. All of the cars which were leased by Plaintiff to Atlantic Discount Company, Inc. during the period involved constituted property used in Plaintiff's trade or business, were not properly includable in Plaintiff's inventory, and were not held primarily for sale in the ordinary course of its trade or business under the meaning of Section 117(j) of the Internal Revenue Code of 1939. See *Philber Equipment Corporation v. Commissioner*, 237 F. 2d 129 (3rd Cir. 1956).

5. The Plaintiff is entitled to long-term capital gains treatment on the profits realized by it from the disposition of those company and leased cars in issue for 1950 and 1951 which had been held for more than six months at the date of sale under Sections 117(a) and 117(j) of the 1939 Code.

6. Plaintiff is entitled to exclude the amount of \$2,177.54 from its taxable income for the year ended December 31, 1951, in connection with the dealer reserves withheld by Atlantic Discount Company. See *Blaine-Johnson v. Commissioner* 233 F. 2d 952 (4th Cir. 1956) and *Keasbey & Mattison Co. v. United States*, 141 F. 2d 163 (3rd Cir. 1944). It appears from the record that the Plaintiff could have excluded \$72,584.00 from its taxable income at the end of 1951 under the authority of the *Blaine-Johnson* and *Keasbey & Mattison* cases, but its failure to do so does not prevent the Plaintiff from excluding the lesser sum of \$2,177.54 as it did in filing its 1951 return.

7. The parties are directed to settle decree accordingly.

the Court having been advised at the hearing that counsel had agreed to compute the amount of refund to which the Plaintiff might be entitled and to submit same to the Court together with a proper form of judgment to be entered in this cause.

BRYAN SIMPSON
United States District Judge

Jacksonville, Florida,

October 7, 1957

William R. Frazier, Esq.,
Attorney for Plaintiff

U. S. Attorney
Attorney for Defendant

Civil Action No. 3346-Civ.-J

FILED JACKSONVILLE, FLA., OCTOBER 31, 1957

JULIAN A. BLAKE, Clerk

STIPULATION

Comes now the parties by their respective counsel and request the Court to amend the Findings of Fact and Conclusions of Law entered October 7, 1957, in the particulars set forth below. The parties hereby agree that the said amendments are in accordance with the evidence presented at the trial of this action:

I

Paragraph 19 of the Findings of Fact should be amended to

read as follows:

"19. All cars and trucks obtained by plaintiff from Chrysler Corporation as a matter of original entry are charged into Account No. 131 on its ledger. When cars or trucks were placed in company use, an entry was made whereby the vehicles were removed from Account No. 131 and placed into the company car account which was designated on Plaintiff's accounting system as Account No. 167. Account No. 131 is the inventory account. Account No. 167 is a fixed asset account."

II

Paragraph 21 of the Findings of Fact should be amended to read as follows:

"21. During 1950, the Plaintiff had 51 company cars in service, of which 23 were leased to Atlantic Discount Company, Inc. (Exhibit 3). During 1950, the plaintiff sold 27 of the 51 cars, 16 of which were held less than six months prior to date of sale and 11 of which were held for more than six months."

III

Paragraph 22 of the Findings of Fact should be amended to read as follows:

"22. During 1951, the Plaintiff had 53 cars in company service, of which 26 were leased to Atlantic Discount Company, Inc. (Exhibit 4). Plaintiff sold 23 of these cars during 1951. (Capital gain has been allowed by the Commissioner of Internal Revenue as

to two of these and are not here in issue.) Of the remaining 21 cars, 9 were held for less than six months prior to the date of sale and 12 were held more than six months."

IV

Paragraph 27 of the Findings of Fact should be amended to read as follows:

"27. During 1950 and 1951, Plaintiff incurred expenses of maintenance and operation of its company cars of approximately \$5,000 to \$6,000 annually. The said expenses were claimed by the Plaintiff on its federal income tax returns as ordinary and necessary business deductions and the said deductions were allowed by the Commissioner of Internal Revenue."

V

Paragraph 28 of the Findings of Fact should be amended to read as follows:

"28. In his opening statement, counsel for the Plaintiff abandoned any issue with respect to the depreciation and capital gain on the sale of a total of 10 cars shown on Exhibits 3 and 4 to have been used by Mrs. W. W. Massey, the wife of Plaintiff's president, and Bob Massey, his son, during the years 1950 and 1951. The Court finds that the vehicle listed in Exhibit 3 as Item 18 was likewise used by Mrs. Massey, and that therefore no depreciation is allowable with respect thereto."

Paragraph 29 of the Findings of Fact should be amended to read as follows:

"29. In its return for the calendar year 1950, Plaintiff deducted \$9,346.69 as depreciation on all of its company cars, including those leased to Atlantic Discount Company, Inc. During the calendar year 1950, Plaintiff sold 27 of the 51 company cars in use and under lease, of which 16 were held less than six months prior to the date of sale. Plaintiff reported a short-term capital gain in the amount of \$10,247.00 with respect thereto. The remaining 11 cars were held more than six months, and Plaintiff reported a long-term capital gain in the amount of \$6,713.21 with respect thereto. In its return for the calendar year 1951, Plaintiff deducted \$11,572.45 as depreciation on its company cars, including those leased to Atlantic Discount Company, Inc. During the calendar 1951, Plaintiff sold 23 of the 53 cars in company use and under lease, of which 9 were held less than six months. Plaintiff reported a short-term capital gain in the amount of \$6,760.41 with respect thereto. Of the remaining 14 cars depreciation and long term-capital gain treatment has been allowed by the Commissioner of Internal Revenue as to 2 and they were not in issue. The remaining 12 cars sold were held more than six months prior to the date of sale, and Plaintiff reported a long-term capital gain in the amount of \$6,925.97 with respect thereto. All of these cars, with the exception of those mentioned in Paragraph 28 above, were used in Plaintiff's trade or business, were not properly includable in Plaintiff's inventory, and were not held primarily

✓

for sale in the ordinary course of its trade or business."

WILLIAM R. FRAZIER

Counsel for Plaintiff

JAMES L. GUILMARTIN

UNITED STATES ATTORNEY

By: **EDITH HOUSE**

ASSISTANT UNITED STATES
ATTORNEY

No. 3346-Civ-J

FILED JACKSONVILLE, FLA., NOVEMBER 6, 1957

JULIAN A. BLAKE, Clerk

**AMENDMENT TO FINDINGS OF FACT AND
CONCLUSIONS OF LAW**

On stipulation of the parties hereto filed herein October 31, 1957, the Court's Findings of Fact and Conclusions of Law, filed in this cause October 7, 1957, is amended in the following respects:

I

Paragraph 19 of the Findings of Fact is amended to read as follows:

19. All cars and trucks obtained by plaintiff from Chrysler Corporation as a matter of original entry are charged into Account No. 131 on its ledger. When cars or trucks were placed in company use, an entry was

made whereby the vehicles were removed from Account No. 131 and placed into the company car account which was designated on Plaintiff's accounting system as Account No. 167. Account No. 131 is the inventory account. Account No. 167 is a fixed asset account.

II

Paragraph 21 of the Findings of Fact is amended to read as follows:

21. During 1950, the Plaintiff had 51 company cars in service, of which 23 were leased to Atlantic Discount Company, Inc. (Exhibit 3). During 1950, the plaintiff sold 27 of the 51 cars, 16 of which were held less than six months prior to date of sale and 11 of which were held for more than six months.

III

Paragraph 22 of the Findings of Fact is amended to read as follows:

22. During 1951, the Plaintiff had 53 cars in company service, of which 26 were leased to Atlantic Discount Company, Inc. (Exhibit 4). Plaintiff sold 23 of these cars during 1951. (Capital gain has been allowed by the Commissioner of Internal Revenue as to two of these and are not here in issue.) Of the remaining 21 cars, 9 were held for less than six months prior to the date of sale and 12 were held more than six months.

IV

Paragraph 27 of the Findings of Fact is amended to read

as follows: 5

27. During 1950 and 1951, Plaintiff incurred expenses of maintenance and operating its company cars of approximately \$5,000 to \$6,000 annually. The said expenses were claimed by the Plaintiff on its federal income tax returns as ordinary and necessary business expense deductions and the said deductions were allowed by the Commissioner of Internal Revenue.

V.

Paragraph 28 of the Findings of Fact is amended to read as follows:

28. In his opening statement, counsel for the Plaintiff abandoned any issue with respect to the depreciation and capital gain on the sale of a total of 10 cars shown on Exhibits 3 and 4 to have been used by Mrs. W. W. Massey, the wife of Plaintiff's president, and Bob Massey, his son, during the years 1950 and 1951. The Court finds that the vehicle listed in Exhibit 3 as Item 18 was likewise used by Mrs. Massey, and that therefore no depreciation is allowable with respect thereto.

VI

Paragraph 29 of the Findings of Fact is amended to read as follows:

29. In its return for the calendar year 1950, Plaintiff deducted \$9,346.69 as depreciation on all of its company cars, including those leased to Atlantic Discount Company, Inc. During the calendar year 1950, Plaintiff sold 27 of the 51 company cars in use and under lease, of which 16 were held less than six months

prior to the date of sale. Plaintiff reported a short-term capital gain in the amount of \$10,247.00 with respect thereto. The remaining 11 cars were held more than six months, and Plaintiff reported a long-term capital gain in the amount of \$6,713.21 with respect thereto. In its return for the calendar year 1951, Plaintiff deducted \$11,572.45 as depreciation on its company cars, including those leased to Atlantic Discount Company, Inc. During the calendar year 1951, Plaintiff sold 23 of the 53 cars in company use and under lease, of which 9 were held less than six months. Plaintiff reported a short-term capital gain in the amount of \$6,760.41 with respect thereto. Of the remaining 14 cars depreciation and long-term capital gain treatment has been allowed by the Commissioner of Internal Revenue as to 2 and they were not in issue. The remaining 12 cars sold were held more than six months prior to the date of sale, and Plaintiff reported a long-term capital gain in the amount of \$6,925.97 with respect thereto. All of these cars, with the exception of those mentioned in Paragraph 28 above, were used in Plaintiff's trade or business, were not properly includable in Plaintiff's inventory, and were not held primarily for sale in the ordinary course of its trade or business.

BRYAN SIMPSON
United States District Judge

Jacksonville, Florida
November 6, 1957

William R. Frazier, Esq.
Attorney for Plaintiff

U. S. Attorney
Attorney for defendant

CIVIL ACTION NO. 3346-Civ.-J.

FILED JACKSONVILLE, FLA., JANUARY 21, 1958

JULIAN A. BLAKE, Clerk

FINAL JUDGMENT

This cause came on to be heard before the Court without a jury on February 20, 1957, at Jacksonville, Florida, and the Court having heretofore made its findings of fact and conclusions of law directing judgment for the plaintiff in the total amount of \$6,133.41, in accordance with an agreed computation between the respective parties hereto, being a part of the corporate income tax deficiencies and interest thereon paid by the plaintiff for the taxable years 1950 and 1951, inclusive, as follows:

<i>Year</i>	<i>Overpayment</i>
1950	\$ 2,732.28
1951	3,401.13
Total	<hr/> \$ 6,133.41

Whereupon, upon consideration thereof, it is

CONSIDERED, ORDERED and ADJUDGED that the plaintiff recover the sum of \$6,133.41, together with interest thereon at the rate of 6% per annum from November 5, 1954, to a date preceding the date of the refund check by not more than thirty days and costs in the amount of \$17.10.

DONE and ORDERED in Chambers at Jacksonville, Duval

County, Florida, this 21st day of January, A. D. 1958.

BRYAN SIMPSON

United States District Judge

Consented to:

JAMES L. GUILMARTIN

U. S. Attorney

By: **EDITH HOUSE**

Asst. U. S. Atty.

No. 3346-Civil-J

FILED JACKSONVILLE, FLA., MARCH 18, 1958

JULIAN A. BLAKE, Clerk

NOTICE OF APPEAL

NOTICE IS HEREBY GIVEN that the United States of America, defendant above named, by its undersigned attorneys, hereby appeals to the United States Court of Appeals for the Fifth Circuit from the Final Judgment entered in this action on January 21, 1958.

JAMES L. GUILMARTIN

United States Attorney

By **E. COLEMAN MADSEN**

Assistant United States Attorney

Attorneys for Defendant-Appellant.

I DO CERTIFY that on this date a copy of the foregoing

Notice of Appeal was furnished by mail to William R. Frazier, Esq., attorney for plaintiffs, at his last known mailing address, namely, 816 Atlantic Bank Building, Jacksonville, Florida.

DATED at Jacksonville, March 18, 1958.

E. COLEMAN MADSEN
Assistant United States Attorney

No. 3346-Civ-J

APRIL 24, 1958

**ORDER EXTENDING TIME FOR FILING
RECORD ON APPEAL**

On oral motion of the defendant, United States of America, and for good cause shown, it is

ORDERED that the said defendant shall have an extension of fifty days from April 27, 1958 to file the transcript of record on appeal in this cause.

DONE and ORDERED at Ocala, Florida, April 24, 1958.

BRYAN SIMPSON
United States District Judge

Hill & Frazier

U. S. Attorney (Madsen)

No. 3346-Civ-J

FILED JACKSONVILLE, FLA., JUNE 11, 1958

JULIAN A. BLAKE, Clerk

**ORDER FOR TRANSMITTAL OF ORIGINAL
EXHIBITS TO COURT OF APPEALS**

On stipulation of the parties and as provided by Rule 75(i),
Federal Rules of Civil Procedure, it is

ORDERED that the plaintiff's exhibits, numbered 1 through
7, inclusive, introduced in evidence in the trial of this cause,
be transmitted to the United States Court of Appeals for the
Fifth Circuit.

DONE AND ORDERED at Jacksonville, Florida, this 11th
day of June, 1958.

BRYAN SIMPSON

UNITED STATES DISTRICT JUDGE

The undersigned move the entry of the
foregoing order.

HILL & FRAZIER

By WILLIAM R. FRAZIER

Attorneys for Plaintiff.

JAMES L. GUILMARTIN

United States Attorney

By EDITH HOUSE

Assistant United States Attorney

Attorneys for Defendant.

CIVIL NUMBER 3346-J

FILED JACKSONVILLE, FLA., JUNE 3, 1958

JULIAN A. BLAKE, Clerk

**DEFENDANT-APPELLANT'S DESIGNATION
OF RECORD ON APPEAL**

Pursuant to Rule 75(a) of the Federal Rules of Civil Procedure, the defendant-appellant herein, United States of America, by its attorney, James L. Guilmartin, United States Attorney in and for the Southern District of Florida, hereby designates the entire record for inclusion in the record on appeal to the United States Court of Appeals for the Fifth Circuit, taken by notice of appeal filed in the above case on the Eighteenth Day of March 1958, including but not limited to the following portions:

1. Complaint
2. Stipulation extending time for defendant to plead
3. Answer
4. Transcript of trial proceedings and plaintiff's exhibits 1-7, inclusive
5. Findings of fact and conclusions of law
6. Stipulation amending findings of fact and conclusions of law.
7. Amendment to findings of fact and conclusions of law

8. Judgment
9. Notice of appeal
10. Motion for extending time for docketing the record on appeal.
11. Order granting extension of time for docketing record on appeal
12. Docket entries
13. This designation

JAMES L. GUILMARTIN
UNITED STATES ATTORNEY

By: EDITH HOUSE, Asst. U. S. Atty.
ATTORNEY FOR DEFENDANT-APPELLANT,
UNITED STATES OF AMERICA.

SOUTHERN DISTRICT OF FLORIDA)

I, JULIAN A. BLAKE, CLERK of the United States District Court in and for the Southern District of Florida, and as such the legal custodian of the records and files of said Court, do hereby certify that the foregoing pages numbered 1 to 123, inclusive, contain a full, true, and correct copy of all such papers and proceedings in the cause of Massey Motors, Inc., Plaintiff, vs. United States of America, Defendant, Case No. 3346-Civil-J., as appear upon the records and files of my office which have been directed to be included in said transcript by the Appellant, United States of America.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the seal of said Court at Jacksonville, Florida on this the 11th day of June, A. D., 1958.

JULIAN A. BLAKE, CLERK
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

BY: ROBERT H. COOKE
Deputy Clerk

(SEAL)

[fol. 132]

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—January 14,
1959 (omitted in printing).

[fol. 133]

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 17279

UNITED STATES OF AMERICA, Appellant,

versus

MASSEY MOTORS, INC., Appellee.

Appeal from the United States District Court for the
Southern District of Florida.

Before Rives, Tuttle and Cameron, Circuit Judges.

OPINION—February 26, 1959

Tuttle, Circuit Judge: The United States in this appeal attacks the judgment of the trial court permitting the appellee taxpayer to take straight line depreciation figured on the entire useful life on certain company-used automobiles sold by the automobile dealer taxpayer after relatively short use by it generally for more than the original cost to the taxpayer.

[fol. 134] Appellee is a franchised Chrysler dealer in Jacksonville, Florida. This case differs from *Duval Motor Company v. Commissioner of Internal Revenue*, 5 Cir., F. 2d, decided today in that on this appeal it is conceded by the government, following a finding to such effect by the trial court, that the automobiles here in issue were property used in the trade or business of the taxpayer.¹

¹ No salesmen's automobiles were involved in this case, and there was no evidence that any of these cars were used substantially for

Massey Motors, Inc., a franchised Chrysler dealer, withdrew from the new cars bought by it during the calendar (and tax) years 1950 and 1951, 51 and 53 automobiles respectively. Of these it assigned approximately one half to its executives and other employees for transportation in connection with the company's business. The other half it rented to an unaffiliated finance company at a net rental of 3 cents a mile. From this rental operation it made a substantial net profit. The executives' cars were uniformly sold at the end of 8,000 to 10,000 miles use or the advent of new models, whichever was earlier. The rental cars were sold at the advent of new models or upon 40,000 miles of use. In nearly every instance the company used cars were sold at a substantial profit above the cost, and on the [fol. 135] average the rented cars were likewise sold at a profit.² The taxpayer figured depreciation on all of the cars on the straight-line basis with no allowance for salvage value. Gains on the sales were computed at capital gains rates with a basis of cost less depreciation.

The Commissioner disallowed the capital gains treatment of the gains and also disallowed the depreciation, contending that the automobiles were not properly used in the trade or business under Section 117(j) of the Internal Revenue Code of 1939, because they were held primarily for sale to customers in the ordinary course of taxpayer's trade or business. The taxpayer paid the resulting deficiency and thereafter filed its claims for refund for the two years. The claims asserted that "the taxpayer contends that it is

any purpose different than if they had been automobiles of a different make from those taxpayer was franchised to sell. On the undisputed facts of this record it seems to us that a respectable case might be made for the proposition that as a matter of law these automobiles sold within the same model year as when bought, and sold generally at a profit above original cost without allowance for depreciation, were held primarily for sale to customers in the ordinary course of taxpayer's business. Since the government does not urge this position, however, and since it is not argued here, we shall not deal further with it.

² The executives' cars here in issue were sold for \$11,272.80 more than their cost and the rental cars were sold for \$525.84 more than their cost.

entitled to a reasonable allowance for depreciation as claimed on the aforementioned automobiles, constituting property used in the trade or business . . . and that the gain realized by it on the sale of said automobiles is reportable as long term capital gain pursuant to the provisions, etc.”³ Upon the disallowance of the claim the suit for refund was filed in the District Court.

The record discloses that the only evidence introduced below related to the business methods of the taxpayer [fol. 136] touching on the use of company and rental cars and their subsequent sale, the essential parts of which are stated above, and testimony as to a small “reserve for repossessions,” later discussed. No evidence was introduced on the depreciation issue apart from that relating to company practices. The trial court held in favor of the taxpayer on the capital gains treatment on the sale of the cars and also made a finding that the rate of depreciation, utilizing a 36-months estimated useful life without deducting any salvage value, was a reasonable and fair rate.

The government here attacks this finding and the court's conclusion that the claimed depreciation should be allowed. The thrust of its position is that depreciation must be figured with relation to the known useful life of the asset in the hands of the taxpayer rather than the entire useful life of the property itself; that depreciation cannot be figured without considering the salvage value at the end of the useful life in the hands of the taxpayer; that it was demonstrated here that the useful life in the hands of Massey Motors, Inc. was less than a year; and that the salvage value more than equaled original cost; thus the depreciation would be zero.

Taxpayer, to the contrary, asserts that whatever may have once been the meaning of useful life “and whatever meaning it may have under current Treasury Regulations promulgated following enactment of the 1954 Code, at the time here in question ‘useful life’ meant the whole useful

³ This claim, which was of course made the basis of the subsequent suit, demonstrates the fallacy of appellee's contention here that the issue of depreciation was not separately raised in the trial court. Taxpayer put this matter in issue. Where the Commissioner makes a determination disallowing depreciation, the burden is on the taxpayer to prove the correctness of the depreciation claimed.

life of the property itself without regard to the length of time it was intended by the taxpayer that it would be used [fol. 137] by him; that the salvage value should properly be that value at the end of the life of the automobiles after they had served their total useful life in the hands of all owners; that total useful life of these automobiles was three years, and that no salvage value would remain thereafter." This is in effect what the trial court held. In light of the facts here that these cars, other than the rented cars, were used approximately 8,000 to 10,000 miles during the first year, and even in the case of the rented cars that they still had a value equaling their cost at the end of the first of the three years, such a holding is so contrary to our knowledge of the facts of life that it must bear close scrutiny.

The statute provides simply that the taxpayer may take as a deduction under the heading of "Depreciation," "a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) (1) of property used in the trade or business."

There is no real dispute between the parties here as to the meaning of the statutory terms. Conceptually depreciation is properly a deductible item because the natural wear and tear upon the capital items which a taxpayer uses to produce his income is a cost element in the production of income. The Supreme Court said in 1926:

"The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that at the end of the useful life of the plant in the business the aggregate of the sums set aside will [fol. 138] (*with the salvage value*) suffice to provide an amount equal to original cost." (Emphasis added.) *United States v. Ludey*, 274 U.S. 295, 300, 301.

We think it clear that the words "of the plant" in this opinion refer to all depreciable assets alike, not only the fixed assets. Appellee here agrees in its brief that a salvage value must be determined before the application of straight line depreciation over a three year life.* It is unfortunate

* In its brief appellee states: "We readily recognize the fact that the cost of a business asset depreciated on the straight line method

that appellee did not "recognize" this principle when it submitted the case to the trial court rather than insist it was entitled to straight three years' depreciation, which it improperly deducted, contrary to all recognized accounting and legal principles, and thus induced so apparent an error in the judgment of the trial court.⁵ Taxpayer's brief concedes that if this question is properly before the court, as we have found it is, the case must be remanded to the trial court to permit it to prove the salvage value—an essential part of its case which it failed to prove on the first trial. It might be simpler for us to reverse the erroneous judgment thus induced by taxpayer and enter judgment dismissing this part of the appellee's suit for failure of proof. [fol. 139] However, since we do not feel that substantial justice would be achieved without allowing an opportunity for taxpayer to furnish the proof necessary under the principles of law properly applicable to the case, we shall not give it that direction.

The principal difficulty in figuring depreciation on property of the kind here used is that it is quite doubtful that Congress ever intended that automobiles temporarily used by people in the business of selling automobiles should be subject to depreciation at all. See *Duval Motor Company v. Commissioner of Internal Revenue*, *supra*. As illustrated by the facts in this record, depreciation of \$347.93 on a company car, bought for \$2086.43, for a holding period of six and a half months, followed by a sale on a capital gains basis of \$2695.00 offends all ideas of the real purpose of

should first be reduced by the estimated salvage value before applying the rate of depreciation in accordance with the decision of the Supreme Court in *United States v. Ludley*, 274 U.S. 295."

⁵ Having filed its claim for refund on its assertion that "it is entitled to a reasonable allowance for depreciation as claimed on the aforementioned automobiles" (emphasis added) the taxpayer squarely assumed the burden of proving the reasonableness of the now concededly erroneous schedule. As pointed out above, there is no merit in taxpayer's contention that the court's finding in favor of this erroneous schedule is not properly before us for consideration.

allowing depreciation.* Recognizing full well that tax effects on businesses are not always uniform and, more important, that the incidence of federal taxation is statutory and not always strictly equitable, or always logical, we think it quite appropriate to consider the apparently unintended result that follows from an asserted construction of the tax laws in performing our duty to construe the language of a statute.

The Tax Court, with the acquiescence of the Commissioner, in *Latimer-Looney Chevrolet Co., Inc. v. Commissioner*, [fol. 140] *supra*, and the trial court in this case having held, without appeal on the part of the government, that cars such as these here in issue are property used in the trade or business and are thus subject to depreciation, it now becomes necessary for us to apply the statute on depreciation with such light as can be gleaned from the Treasury Regulations and the Tax Court and trial and appellate court decisions.⁷

Taxpayer urges that the construction it advances is consistent with that promulgated by the Commissioner himself, since in Regulations in effect during the tax years in question it is stated:

"The capital sums to be recovered shall be charged off over the useful life of the property, either in equal annual installments, or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production." Treasury Reg. 702, Sec. 29.23 (1-5) 1939 Code.

Taxpayer contrasts this with the language in corresponding regulations in existence prior to 1942, the date of the promulgation of the above quoted language. In point of fact, there is no change in the language in the corresponding sections which deal with "Method of computing de-

* As we roughly compute the tax savings, solely because of the use of depreciation on these company cars where they are accorded capital gains treatment on sale, the automobile mentioned above instead of yielding Massey Motors a return after taxes, of \$250.38 on the suggested Chrysler mark-up of 25%, the automobile, after seven months' use by the company, would yield a return, after taxes, of \$550.34.

preciation." Both before and after 1942 the relevant language of this section of the Regulations was the same. See Section 27.23 (1-5) for 1939 and as amended on Dec. 8, 1942. The change in language in regulations under the depreciation section of the 1939 Code appears in Section 29.23 (1-1). Prior to Dec. 8, 1942, this section, which in [fol. 141] reality appears to be a definition section rather than a regulation telling how to compute depreciation, provided in essential part:

"A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the *useful life of the property in the business*, equal the cost or other basis of the property" (Emphasis added.)

Taxpayer here seems to concede, as we think it must, that if this regulation had been in effect during the tax years here in issue, the useful life of the automobiles would be the life in the hands of the taxpayer. In fact we think the quoted language from *United States v. Ludey, supra*, is determinative of the matter. It clearly says the test is *the end of the useful life of the plant in the business*.

Taxpayer points to a change in the amended regulations promulgated in 1942, as indicating change in the Commissioner's interpretation of the statute in this respect. [fol. 142] The corresponding language of the 1942 amended regulation is as follows:

"A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under [Reg.] section 19.23 (a)-15 as held by the taxpayer for the production of income may be deducted from gross income. For con-

venience such an allowance will usually be referred to as depreciation The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the *depreciable property*, equal the cost or other basis of the property"

It will be apparent that in the last sentence the words "property in the business" has been eliminated and the words "depreciable property" substituted. A cursory look at the legislative history back of this amendment clearly demonstrates that there was no purpose to express a change in what was meant by useful life. This change was necessitated by an amendment in 1942 to the 1939 Code, which added as property entitled to depreciation "property held for the production of income." Thus the regulation which had theretofore dealt only with property used in the trade or business was inadequate, and it had to be amended by the inclusion of the italicized words above. The last sentence could not, of course, thereafter adequately cover both [fol. 143] classes of property by referring to "property in the business" because this would not include the new class "property held for the production of income." The language "depreciable property" would, of course, cover both, and it was substituted for "property in the business."

Thus, we think it clear that whatever was understood by the Treasury Department prior to 1942 by useful life remained unchanged by the amendments here discussed. Thereafter, when the 1954 Internal Revenue Code was adopted, without any change in the depreciation section of the law, the Treasury promulgated the Regulations under it. They expressly provide:

"Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset *when it is no longer useful in taxpayer's trade or business or in the production of his income and is to be retired by the taxpayer.*" (Emphasis added.)

It must be borne in mind that there has been no change in the basic statute in any matter here relevant during the entire period of time. We should thus be inclined to look with considerable disfavor on any contention that a slight change in Regulations worked such a double shift in the effect of a simple statute allowing reasonable depreciation. We do not think the Commissioner's Regulations could change the basic concept of depreciation from that announced by the Supreme Court in the Ludey case.

[fol. 144] We are supported in our conclusion that there has been no intent by the Commissioner to effect such a change by the further significant fact that prior to and after the 1942 change in Regulations, there was outstanding the Treasury's Bulletin F, universally recognized by all and sundry familiar with tax problems as representing the Treasury's theories as to the application of depreciation.

This Bulletin includes the following language under the heading "Allowance for Depreciation and Obsolescence":

"The proper allowance for exhaustion, wear and tear, including obsolescence, of property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) whereby the aggregate of the amounts so set aside, plus the salvage value, will at the end of the useful life of the property in the business, equal the cost or other basis of the property." (Emphasis added.)

It will thus be seen that notwithstanding the change in Regulation Section 29.23 1-1 in December, 1942, no change has been made in Bulletin F which purports to show the

Of course, in its initial publication, the Internal Revenue Service was careful to disclaim any authoritative standing for the specific items treated within Bulletin F. Nevertheless, when it was republished in January, 1942, it stated:

"It contains information and statistical data relating to the determination of deductions for depreciation and obsolescence, from which taxpayer and their counsel may obtain the best available indication of Bureau practice and the trend and tendency of official opinion in the administration of pertinent provisions of prior Revenue Acts."

[fol. 145] "tendency of official opinion" in the Internal Revenue Service. It cannot well be said that the change above discussed was intended to, or did, change the meaning of useful life.

We conclude that as to a taxpayer so placed that his business experience has taught that automobiles, bought by him for sale but temporarily assigned for use in the business with use in the business averaging less than one third of their total usable life,⁸ such automobiles are depreciable by him on the basis of his expected use of the cars in his business and not on the basis of the length of time the car is expected to be usable as a passenger automobile.⁹

The statute allows a reasonable amount for depreciation. No regulation, although valid and binding to the extent it does not enlarge or conflict with the statute, can bind the Commissioner to the allowance of anything more than a reasonable deduction for a whole class of taxpayers. A construction of this regulation as contended for by this taxpayer would result in not only a grossly unreasonable deduction for depreciation, but would offend the basic concept of depreciation and its purpose. We, therefore, cannot [fol. 146] approve a construction of the regulation that would reach this result, or if we did so, we would have to hold it invalid as to the factual situation here present as not being authorized by the statute.

⁸ We have not here commented on the short life of three years here accepted by the trial court. Bulletin F, above referred to, suggests a life of business automobiles, upon the assumption that their entire life is to be a business one rather than for individual or family use, of five years for all except salesmen. It would seem quite unlikely that a useful life of three years for a passenger automobile used only 8,000 to 10,000 miles the first year would be sustainable even on the taxpayer's theory of the law upon a full development of the case. In any event the correct rate of depreciation is dependent upon proof. None was offered by the taxpayer to justify its taking this unrealistically short life without even providing for any salvage value.

⁹ For a clear and convincing discussion and analysis of this problem, leading the author to the same conclusion we have reached see Montgomery's *Federal Taxes*, 37th Edition, Chapter 6, page 4, et seq.

As we have previously stated, the basic difficulty here arises from the application of depreciation to a type of property held in such circumstances as would raise much doubt that they were considered as depreciable assets when the law was enacted. So long as taxpayers normally used their capital and other business property for the period of time that they had any substantial vitality left in them the regulations, construed either way, were satisfactory. But when, as here the courts, over the commissioner's opposition, gave Section 117(j) treatment including the right to depreciation, to property used as were these automobiles, it cannot, we think, be said that the Commissioner is bound to his construction of the regulations published under different circumstances, and especially when he consistently took the position that the depreciation regulations did not apply here at all. When he lost that argument he then issued new regulations which do precisely cover this type of property as used here. In doing so he did not intend to and did not—he *could* not—change the law. For us to hold that the new regulations of 1956 had the effect of defining useful life as useful life in the business for the first time would amount to our saying that the Commissioner could by Regulations change the law.

We realize that this conclusion brings us to a different result from that reached by the Court of Appeals for the [fol. 147] Ninth Circuit in *Evans v. Commissioner of Internal Revenue*, 9 Cir., F. 2d, dec. Jan. 26, 1959, which has been brought to our attention after argument. With deference, we think that decision, reached after a well-reasoned and painstaking analysis, too greatly emphasizes the Regulations as portraying the Commissioner's position. In effect it says that there is no shifting back and forth by the Commissioner on this construction; but that he has always construed useful life as the total life of usefulness and that he is bound by this consistent practice. There is much to be said for the proposition that taxpayers have a right to rely on the clearly announced construction placed on the laws by the administrative officials whose duty it is to write the regulations and apply them administratively. This is well stated by the excellent opinion in the Adams case. But we feel that that court has overlooked the essential

point that all the time these regulations were in effect the Commissioner was making known by litigating everywhere his position that these regulations were not applicable here, no matter how they were construed because he was contending that these were not depreciable assets at all. Under these circumstances, it could not be said that a taxpayer, so circumstanced as Massey Motors, Inc., could rely on the Treasury's position as saying that he could use the combination of capital gains treatment with depreciation deductions to double its profits after taxes on the sale of such assets. So long as the Commissioner was proclaiming at every opportunity that the depreciation regulation did not apply to this situation at all, it cannot be said that he is bound by language which took on no real significance until [fol. 148] the courts held against him on his contention. Thereafter he is free, it seems to us, to argue a construction of the regulations that carries out the intent of the statute rather than being bound by one which frustrates it.

The government contends that as a necessary corollary to our conclusion we should find that on the record here the salvage value at the end of this useful life, approximating one year, exceeds cost, and that no depreciation can be taken at all. We think that the attention of the trial court and both parties was so concentrated on the legal principle that too little attention was paid to the fact issue: what would be a reasonable allowance for depreciation under the principles of law here laid down? Without argument touching the point we should not decide for instance whether salvage value should be the value of the company cars at retail, since that is how they are sold, or whether, since much of the value of the cars in the hands of this taxpayer results from the fact that it is a large buyer and seller of automobiles, the salvage value should be on the wholesale market, since that is the market on which it buys them. We think these matters must be developed on a new trial, which can be limited to such issues as are here discussed without retrying the other issue on which the government does not appeal.

As to the remaining point in the case, the right of the taxpayer to deduct from income for 1951 a small reserve called "Reserve for Repossessions," the parties agree that

the same issue has recently been decided by this Court against the government in *Texas Trailercoach, Inc. v. Commissioner*, 5 Cir., 251 F. 2d 395, and also by other Courts of Appeals in *Johnson v. Commissioner*, 4 Cir., 233 F. 2d 952, *Glover v. Commissioner*, 8 Cir., 253 F. 2d 735, *Hansen v. Commissioner*, 9 Cir., F. 2d We think we are bound by those decisions and therefore affirm the action of the trial court touching on this issue. Of course, no final judgment will be entered in the trial court immediately, and in the event the Supreme Court on certiorari already filed decides contrary to our views, the trial court can and should give effect to its decision.

Judgment Reversed for further proceedings not inconsistent with this opinion.

CAMERON, Circuit Judge: I dissent.

[fol. 150]

IN UNITED STATES COURT OF APPEALS

No. 17279

UNITED STATES OF AMERICA,

versus

MASSEY MOTORS, INC.

JUDGMENT—February 26, 1959

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

On Consideration Whereof, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed for further proceedings not inconsistent with the opinion of this Court.

"Cameron, Circuit Judge, dissenting."

[fol. 151] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 153]

SUPREME COURT OF THE UNITED STATES

No., October Term, 1958

MASSEY MOTORS, INC., Petitioner,

vs.

UNITED STATES OF AMERICA.

ORDER EXTENDING TIME TO FILE PETITION FOR
WRIT OF CERTIORARI—May 22, 1959

Upon Consideration of the application of counsel for petitioner(s),

It Is Ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including

July 13, 1959.

Hugo L. Black, Associate Justice of the Supreme Court of the United States.

Dated this 22 day of May, 1959.

[fol. 155]

SUPREME COURT OF THE UNITED STATES
No. 141, October Term, 1959

[Title omitted]

ORDER ALLOWING CERTIORARI—October 12, 1959

The petition herein for a writ of certiorari to the United States Court of Appeals for the Fifth Circuit is granted. The case is transferred to the summary calendar and set for argument immediately following No. 283.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Year ended 12-31-50

Description	Serial Number	Date Purchased	Cost	Sale Price	Depreciation				Inventory		
					1948	1949	1950	Total	Added To	Removed From	Returned To
Dodge Route Van	84202046	11-19-48	253824	165000 (1)		84624	21150	105774	11-19-48	6-14-49	3-30-50
Dodge Coronet Conv. Cpe.	31363525	8-30-49	195802	201982 (2)		16348	5438	21786	8-30-49	9-17-49	1-20-50
Dodge Coronet 4-Door	31364914	8-31-49	174109	209500 (3)		14521	4836	19357	8-31-49	9-21-49	1-4-50
Dodge Coronet 7m. Sedan	31398360	10-12-49	185094	209500 (4)		10300	5141	15441	10-12-49	10-31-49	1-17-50
Dodge Coronet Cb. Cpe.	31402591	10-19-49	173893	199500 (5)		9673	4830	14503	10-19-49	10-31-49	1-2-50
Dodge Coronet Cb. Cpe.	31414530	11-1-49	173246	197700 (6)		4836	4806	9642	11-1-49	11-8-49	1-1-50
Dodge Coronet Cb. Cpe.	31414815	11-1-49	173047	209500 (7)			19255	19255	11-1-49	12-21-49	1-1-50
Dodge Coronet Cb. Cpe.	31424157	12-31-49	186074	249500 (8)			10262	10262	12-21-49	1-4-50	1-1-50
Dodge Coronet Conv. Cpe.	31440608	1-3-50	202682	282930 (9)			28152	28152	1-3-50	1-21-50	1-29-50
Dodge Coronet Cb. Cpe.	31473665	6-5-50	170484	269500 (10)			18964	18964	6-5-50	6-13-50	10-7-50
Plt. Spec. Fly Cb. Cpe.	12456665	6-17-50	145022	210000 (11)			4030	4030	6-17-50	6-29-50	7-1-50
Dodge Coronet Cb. Cpe.	31467939	6-12-50	189400	187750 (12)			21048	21048	6-12-50	6-12-50	7-5-50
Plt. Spec. Fly Cb. Cpe.	12447564	6-15-50	147510	147510 (13)					6-15-50	6-15-50	6-29-50
Plt. Spec. Fly Cb. Cpe.	12447388	6-7-50	147510	150000 (14)			16406	16406	6-7-50	6-15-50	11-3-50
Plt. Spec. Fly Cb. Cpe.	12457446	6-7-50	186831	229500 (15)			15594	15594	6-7-50	6-24-50	7-10-50
Dodge Coronet Cb. Cpe.	31508221	7-12-50	183687	225000 (16)			5117	5117	7-12-50	8-2-50	1-1-50
Dodge Coronet Cb. Cpe.	31515524	7-19-50	181036	249310 (17)			10084	10084	7-19-50	8-10-50	1-1-50
Dodge Coronet 4-Door	31532362	9-11-50	195600	288515 (18)			10878	10878	9-11-50	9-11-50	1-14-50
Dodge Coronet 4-Door	31451943	5-19-50	198950	248595 (19)			11066	11066	5-19-50	6-14-50	7-31-50
Plt. Spec. Fly 4-Door	12483993	4-18-49	140637	125000 (20)		31269	27342	58611	4-18-49	4-22-49	7-1-50
Plt. Spec. Fly Cb. Cpe.	12166079	3-31-49	145118	137500 (21)		37250	28217	60467	3-31-49	4-8-49	6-2-50
Plt. Spec. Fly 4-Door	12193691	4-26-49	136312	159500 (22)		26518	26502	53020	4-26-49	5-3-49	7-4-50
Dodge Mayflower 2-Door	37003691	5-25-49	149985	169500 (23)		25006	16664	41669	5-25-49	6-1-49	4-1-50
Plt. Spec. Fly 4-Door	12133349	5-24-49	193715	132500 (24)		32315	32280	64595	5-24-49	6-2-49	6-2-50
Plt. Spec. Fly Cb. Cpe.	12230009	6-13-49	136656	149500 (25)		22776	22776	45552	6-13-49	6-25-49	6-2-50
Dodge Coronet Conv. Cpe.	31317353	6-28-49	208643	269500 (26)		28998	5725	34793	6-28-49	7-6-49	1-14-50
Plt. Spec. Fly 4-Door	12211872	7-19-50	180000	140000 (27)		20000	30000	50000	7-19-50	8-15-49	7-28-50
Dodge Coronet 4-Door	31394705	10-6-49	166061	181970 (28)		9253	27632	36925	10-6-49	10-28-49	6-8-50
Plt. Spec. Fly 4-Door	12363135	11-2-49	142960	145250 (29)		3925	27797	31722	11-2-49	11-15-49	7-6-50
Dodge Coronet Cb. Cpe.	31420178	12-21-49	186423	240000 (30)			31093	31093	12-21-49	1-3-50	7-27-50
Dodge Coronet 4-Door	31425592	12-22-51	186978	239500 (31)			41542	41542	12-22-51	1-3-50	7-1-50
Dodge 216 Super Truck	81252709	4-19-48	117604		52562	39192	24850	117604	4-19-48	4-21-48	
Maytag-Davidson Farm Lap	4884656	7-30-48	99825		16665	33264	33264	83193	7-30-48	7-30-48	
Dodge B108 Conv. 7m	82076173	9-7-48	117065		2782	37012	37012	87806	9-7-48	9-16-48	
Dodge HMC-158 Wrecker	80364506	3-29-49	332250			7838	110748	184586	3-29-49	4-29-49	
Maytag-Davidson Tractor	4961208	8-25-49	50066			5584	16656	22240	8-25-49	8-25-49	
Maytag-Davidson Tractor	6812713	8-25-49	86710			28904	28918	57822	8-25-49	8-25-49	
Dodge M-Road 4-Door	31444966	1-19-50	168441				46812	46813	1-19-50	2-1-50	
Plt. Spec. Fly Cb. Cpe.	12447337	6-2-50	147660				24630	24630	6-2-50	6-8-50	
Plt. Spec. Fly Cb. Cpe.	12441749	6-2-50	147660				24630	24630	6-2-50	6-8-50	
Plt. Spec. Fly Cb. Cpe.	12448524	6-2-50	154220				25730	25730	6-2-50	6-8-50	
Dodge Coronet 4-Door	31475947	6-7-50	183175				30535	30535	6-7-50	6-16-50	
Plt. Spec. Fly Cb. Cpe.	12457610	6-16-50	141102				23532	23532	6-16-50	6-23-50	
Plt. Spec. Fly Cb. Cpe.	12457503	6-16-50	141107				23532	23532	6-16-50	6-23-50	
Plt. Spec. Fly Cb. Cpe.	12441513	6-3-50	154435				25265	25265	6-3-50	6-13-50	
Plt. Spec. Fly Cb. Cpe.	12447545	6-7-50	147516				24660	24660	6-7-50	6-15-50	

328	Manner of Sale	Used by	Primary Purpose	Duration of Use	Registration Insurance	Finances
	Retail Wholesale		Demonstrator		TAXED + TITLED IN COMPANY NAME AND DEALER TAGS USED	CASH TAXES NOT FINANCE
-30-50	Retail	Atlantic Discount Co.	Leave	① 290 days, approximately		
-26-50	"	Mrs. W.W. Massey		② 132 days		
-4-50	"	General Manager		③ 106 days		
-17-50	"	President		④ 79 days		
1-2-50	"	Sen. Sales Manager		⑤ 64 days		
-7-50	"	New Truck Sales Manager		⑥ 61 days		
+14-50	"	Atlantic Discount Co.	Leave	⑦ 115 days		
3-27-50	"	Vice President		⑧ 82 days		
5-29-50	"	Sen. Sales Manager		⑨ 60 days		
10-7-50	"	Atlantic Discount Co.	Leave	⑩ 117 days		
7-21-50	"	"	Leave	⑪ 23 days		
10-25-50	"	"	Leave	⑫ 13 days		
6-29-50	"	"	Leave	⑬ 15 days		
10-3-50	"	"	Leave	⑭ 111 days		
9-12-50	"	Bob Massey		⑮ 81 days		
9-1-50	"	President		⑯ 31 days		
10-30-50	"	Sen. Sales Manager		⑰ 52 days		
11-14-50	"	President		⑱ 65 days		
7-31-50	"	General Manager		⑲ 48 days		
7-1-50	"	Atlantic Discount Co.	Leave	⑳ 436 days		
2-3-50	"	"	Leave	㉑ 302 days		
7-14-50	"	"	Leave	㉒ 438 days		
4-14-50	"	New Truck Sales Manager		㉓ 318 days		
6-29-50	"	Atlantic Discount Co.	Leave	㉔ 393 days		
6-14-50	"	"	Leave	㉕ 354 days		
1-19-50	"	Vice President		㉖ 149 days		
7-25-50	"	Atlantic Discount Co.	Leave	㉗ 345 days		
6-8-50	"	Transport Manager		㉘ 224 days		
7-6-50	"	Atlantic Discount Co.	Leave	㉙ 234 days		
7-27-50	"	President		㉚ 206 days		
9-11-50	"	Mrs. W.W. Massey		㉛ 252 days		
		Louis Truck		㉜		
		Light Duty Co.		㉝		
		Parts Co.		㉞		
		Warehouse		㉟		
		Service Bldg.		㊱		
		Mobile Home		㊲		
		Atlantic Discount Co.	Leave	㊳		
		"	Leave	㊴		
		"	Leave	㊵		
		"	Leave	㊶		
		General Manager		㊷		
		Atlantic Discount Co.	Leave	㊸		
		"	Leave	㊹		
		"	Leave	㊺		
		"	Leave	㊻		
		"	Leave	㊼		
		"	Leave	㊽		
		"	Leave	㊾		
		"	Leave	㊿		

Coverage
New cars in inventory: Full, that comprehensive
Company cars: Full, that comprehensive public liability
and property damage.

Description	Serial Number	Date Purchased	Cost	Sale Price	Laboratory				Inventory	Removed	Retained
					1948	1949	1950	Total			
50 Phe. Hec - Dly. Cl. Che	12447489	6-7-50	147510	(47)	-	-	24600	24600	6-7-50	6-15-50	-
50 Phe. Hec - Dly. Cl. Che	31548088	8-17-50	218469	(48)	-	-	24293	24293	8-17-50	8-29-50	-
50 Phe. Hec - Dly. Cl. Che	12514449	8-23-50	177024	(49)	-	-	19128	19128	8-23-50	8-29-50	-
50 Phe. Hec - Dly. Cl. Che	31553853	9-20-50	210765	(50)	-	-	12583	17583	9-20-50	9-15-50	-
50 Phe. Hec - Dly. Cl. Che	31588978	10-16-50	197832	(51)	-	-	11202	11202	10-16-50	10-25-50	-
50 Phe. Hec - Dly. Cl. Che	31600773	10-12-50	173388	(52)	-	-	4828	4828	10-12-50	11-14-50	-
50 Phe. Hec - Dly. Cl. Che	31614589	10-25-50	215012	(53)	-	-	5992	15992	10-25-50	11-16-50	-
50 Phe. Hec - Dly. Cl. Che	31492868	6-23-50	166389	(54)	-	-	22679	22679	6-23-50	7-31-50	-
50 Phe. Hec - Dly. Cl. Che	82169852	6-30-50	114600	(55)	-	-	15927	15927	6-30-50	7-31-50	-
50 Phe. Hec - Dly. Cl. Che	31526851	8-8-50	180225	(56)	-	-	15000	15000	8-8-50	9-1-50	-
50 Phe. Hec - Dly. Cl. Che	5161158	10-1-50	116590	(57)	-	-	6498	6498	10-1-50	10-31-50	-

80009, 592495, 1210542, 1883046

Date sold	Name of L&L	Used by	Primary Purpose	Duration of Use	Registration	Insurance	Financed
	Retail Wholesale	Atlantic Lumber Co, lease					
		Vice President					
		Bob Massey					
		President					
		Atlantic Lumber Co, lease					
		Gen. Sales Manager					
		Mrs. W. J. Massey					
		General Manager	Parts and Service				
		General Manager	Parts and Service				

TAXED +
TITLED IN
COMPANY'S
NAME -
NO DEALER
TAGS USED

CASH
TRANSACTION -
NOT FINANCED

Don't Policy by Company
Don't Policy by Service

(47)
(48)
(49)
(50)
(51)
(52)
(53)
(54)
(55)
(56)
(57)

Massachusetts, Inc.
Vehicles Used and Sold
Year ended 12-31-51

Description	Serial Number	Date	Cost	Sale Price	1948	1949	1950	1951	Total	Added to	Removed from	Returned to
50 Dodge Coronet Diplomat	31548098	8-11-50	(58) 218469	295000	—	—	24292	12126	26429	8-11-50	8-29-50	2-28-51
50 Plymouth - 4 Dr Conv. Cpe	12514449	8-23-50	(59) 171024	199500	—	—	19128	9556	28684	8-23-50	8-29-50	2-7-51
50 Dodge Coronet Diplomat	31553853	9-31-50	(60) 210765	250000	—	—	17583	11708	29291	9-31-50	9-15-50	2-6-51
50 Dodge Coronet Diplomat	31588978	10-16-50	(61) 177832	259500	—	—	11002	10790	21792	10-16-50	10-25-50	2-23-51
50 Dodge Coronet 4 Dr Cpe	31600773	10-12-50	(62) 173388	201000	—	—	4828	9632	14460	10-12-50	11-14-50	2-12-51
50 Dodge Coronet Diplomat	31614589	10-25-50	(63) 215062	297645	—	—	5992	5972	11964	10-25-50	11-16-50	1-31-51
51 Dodge Coronet Conv. Cpe	31665432	1-9-51	(64) 224886	269500	—	—	—	31222	31222	1-9-51	1-30-51	6-19-51
51 Dodge Coronet 4 Dr Cpe	31674196	1-24-51	(65) 177351	24462	—	—	—	9867	9867	1-24-51	2-12-51	4-7-51
51 Dodge Coronet 4 Dr Cpe	31691613	2-14-51	(66) 189110	191704	—	—	—	10508	10508	2-14-51	3-6-51	5-30-51
51 Dodge Coronet 4 Dr Cpe	31718609	4-11-51	(67) 194477	202625	—	—	—	—	—	4-11-51	4-16-51	5-16-51
51 Dodge Coronet 4 Dr Cpe	31693633	3-29-51	(68) 248865	250000	—	—	—	27681	27681	3-29-51	4-24-51	8-25-51
50 Ford 2-Door Sedan	B0AT115078	4-20-51	(69) 111905	130000	—	—	—	9341	9341	4-20-51	4-26-51	7-11-51
51 Dodge Coronet 4 Dr Cpe	31257106	4-21-51	(70) 195017	195017	—	—	—	5457	5457	4-21-51	5-16-51	7-5-51
51 Dodge Coronet Diplomat	31431979	8-13-51	(71) 204333	210873	—	—	—	11383	11383	8-13-51	8-30-51	10-17-51
51 Dodge 2-Door Cpe	81252707	4-19-48	(72) 117614	79500	53562	39192	24850	—	117604	4-19-48	4-21-48	3-17-51
51 Dodge B108 Cpe	82026173	4-7-48	(73) 117065	87500	9782	39012	95012	3251	91057	9-7-48	9-16-48	1-29-51
50 Dodge M-Book 4-Door	31444966	1-19-50	(74) 168441	185000	—	—	46813	23390	70203	1-19-50	2-1-50	5-10-51
50 Plymouth - 4 Dr Cpe	12442337	6-2-50	(75) 147660	130000	—	—	24630	20505	45135	6-2-50	6-8-50	5-25-51
50 Plymouth - 4 Dr Cpe	12441749	6-2-50	(76) 147660	137500	—	—	24630	28707	53337	6-2-50	6-8-50	7-2-51
50 Plymouth - 4 Dr Cpe	12447545	6-7-50	(77) 147510	140000	—	—	24600	26873	61473	6-7-50	6-15-50	7-12-51
50 Plymouth - 4 Dr Cpe	12447489	6-7-50	(78) 147510	115000	—	—	24600	20485	45085	6-7-50	6-15-50	5-30-51
50 Dodge Coronet 4 Dr Cpe	31485947	6-7-50	(79) 183175	191000	—	—	30535	15264	45799	6-7-50	6-16-50	3-3-51
50 Plymouth - 4 Dr Cpe	12457610	6-16-50	(80) 141102	120000	—	—	23532	19595	43127	6-16-50	6-23-50	5-30-51
50 Plymouth - 4 Dr Cpe	12457503	6-16-50	(81) 141102	135000	—	—	23532	23514	47046	6-16-50	6-23-50	6-20-51
50 Dodge Coronet 4 Dr Cpe	31492868	6-23-50	(82) 166389	199000	—	—	22679	18464	41163	6-23-50	7-1-50	4-16-51
50 Dodge Coronet 4 Dr Cpe	31526951	8-8-50	(83) 180725	262995	—	—	15000	10338	25338	8-8-50	9-1-50	2-28-51
50 Dodge Coronet 4 Dr Cpe	31663014	12-11-50	(84) 188142	195000	—	—	—	41814	41814	12-11-50	1-22-51	9-1-51
51 Dodge Coronet Diplomat	31698675	2-28-51	(85) 206813	287228	—	—	—	39143	39143	2-28-51	3-21-51	10-26-51
49 Harley-Davidson Iron Horse	4864456	7-30-48	(86) 99825	—	16.65	33264	33264	16632	99825	7-30-48	7-30-48	2-30-48
49 Dodge HHC 128 7 Seater	80264506	2-24-49	(87) 332257	—	—	73838	110748	110748	295334	3-29-49	4-29-49	4-29-49
49 Indian Arrow Motorcycle	8212713	8-22-47	(88) 50000	—	—	5584	16656	16656	38876	8-25-49	8-25-49	8-25-49
49 Harley-Davidson Iron Horse	4961208	8-15-49	(89) 86710	—	—	28904	28918	28888	86710	8-25-49	8-25-49	8-25-49
50 Plymouth - 4 Dr Cpe	12440524	6-2-50	(90) 154220	—	—	—	25730	51396	17726	6-2-50	6-8-50	6-13-50
50 Plymouth - 4 Dr Cpe	12441393	6-3-50	(91) 154435	—	—	—	25265	51468	77233	6-3-50	6-13-50	6-13-50
51 Dodge 1/2 Ton Cpe	82210677	12-18-50	(92) 115351	—	—	—	—	35250	35250	12-18-50	1-5-51	1-5-51
51 Dodge 1/2 Ton Cpe	81295220	12-19-50	(93) 131920	—	—	—	—	40320	40320	12-19-50	1-7-51	1-7-51
51 Dodge Coronet 4-Door	31687313	2-13-51	(94) 186063	—	—	—	—	51431	51431	2-13-51	2-5-51	2-5-51
51 Chrysler Cordoba Conv. Cpe	17655748	2-5-51	(95) 185149	—	—	—	—	48627	48627	1-18-51	2-6-51	2-6-51
51 Dodge Coronet 4 Dr Cpe	31671234	1-18-51	(96) 175039	—	—	—	—	34855	34855	2-15-51	3-13-51	3-13-51
51 Chrysler Cordoba 4 Dr Cpe	12678947	2-15-51	(97) 139372	—	—	—	—	32194	32194	4-4-51	4-6-51	4-6-51
51 Chrysler Cordoba 4 Dr Cpe	12718670	4-4-51	(98) 144838	—	—	—	—	28232	28232	5-17-51	5-28-51	5-28-51
51 Chrysler Cordoba 4 Dr Cpe	1270818	5-17-51	(99) 145073	—	—	—	—	28399	28399	5-3-51	5-18-51	5-18-51
51 Chrysler Cordoba 4 Dr Cpe	12749943	5-3-51	(100) 146073	—	—	—	—	25744	25744	3-31-51	5-7-51	5-7-51
51 Chrysler Cordoba 4 Dr Cpe	12715999	3-31-51	(101) 145172	—	—	—	—	41198	41198	4-10-51	5-8-51	5-8-51
51 Dodge Coronet 4-Door	31237688	4-10-51	(102) 178775	—	—	—	—	24753	24753	6-15-51	6-25-51	6-25-51
51 Dodge Coronet 4 Dr Cpe	1276731	6-15-51	(103) 145483	—	—	—	—	—	—	—	—	—

Debit

2
2
2
2
2
1
6
4
5
5
8
7
7
16
3
1
5
5
7
9
3
5
6

[fol. 159]

Date Sold	Names of Sale	Used by	Primary Purpose	Duration of Use	Registration Insurance Financial
2-28-51	Ward	Vice President		58 184 days, approximately	TAKED +
2-7-51	"	Bob Maskey		59 173 days	TITLED
2-6-51	"	President		60 175 days	IN COMPANY
2-23-51	"	Atlantic Discount Co.	Lease	61 122 days	NAME -
2-12-51	"	Gen Sales Manager		62 91 days	NO DEALER
1-31-51	"	Mrs. W. W. Maskey		63 77 days	TAKES USED
6-19-51	"	Vice President		64 141 days	
4-7-51	"	Gen Sales Manager		65 55 days	
5-30-51	"	Gen Manager		66 86 days	
5-16-51	"	Gen Manager		67 31 days	
8-25-51	"	Vice President		68 124 days	
7-11-51	"	Atlantic Discount Co.	Lease	69 77 days	
7-5-51	"	Gen Manager		70 51 days	
10-17-51	"	Mrs. W. W. Maskey		71 49 days	
3-17-51	"		Lease	72 106 days	
1-29-51	"	Atlantic Discount Co.	Lease	73 86 days	
5-10-51	"	"	Lease	74 463 days	
5-25-51	"	"	Lease	75 351 days	
7-2-51	"	"	Lease	76 389 days	
9-12-51	"	"	Lease	77 455 days	
5-30-51	"	"	Lease	78 351 days	
3-7-51	"	Gen Manager		79 261 days	
5-30-51	"	Atlantic Discount Co.	Lease	80 342 days	
6-20-51	"	"	Lease	81 362 days	
4-16-51	"	Gen Manager		82 290 days	
2-28-51	"	Gen Manager		83 181 days	
9-1-51	"	Mrs. W. W. Maskey		84 223 days	
10-26-51	"	President		85 219 days	
			Parts Del	86	
			Wrecker	87	
			Messenger	88	
			Lease	89	
			Lease	90	
			Parts Del	91	
			Lease	92	
			Lease	93	
			Lease	94	
			Lease	95	
			Lease	96	
			Lease	97	
			Lease	98	
			Lease	99	
			Lease	100	
			Lease	101	
			Lease	102	
			Lease	103	

Covered by blanket policy by company.
Lease have covered by Maskey

Description	Serial Number	Date Purchased	Lot	Sale Price	1948		1949		Repurchased		Total Cost to To	Inventory	
									1950	1951		Remains	Returned
51 Ply Cranbrook Clb Che	12789544	6-18-51	(10)	144485	—	—	—	—	—	—	24095	24095	6-18-51
51 Ply Cranbrook Clb Che	1278616	6-18-51	(10)	144480	—	—	—	—	—	—	24000	24000	6-18-51
51 Ply Cranbrook Clb Che	12788752	6-25-51	(10)	146625	—	—	—	—	—	—	20393	20393	6-25-51
51 Ply Cranbrook Clb Che	12801672	6-22-51	(10)	147326	—	—	—	—	—	—	20474	20474	6-22-51
51 Dodge Coronet Riplanet	31797365	6-18-51	(10)	219751	—	—	—	—	—	—	30527	30527	6-18-51
51 Ply Cranbrook Clb Che	12841789	8-20-51	(10)	146437	—	—	—	—	—	—	16293	16293	8-20-51
51 Ply Cranbrook Clb Che	12825388	7-26-51	(10)	145701	—	—	—	—	—	—	16197	16197	7-26-51
51 Ply Cranbrook Clb Che	12842201	8-20-51	(11)	146187	—	—	—	—	—	—	8147	8147	8-20-51
51 Dodge Coronet Cnw Che	31847202	9-12-51	(11)	219101	—	—	—	—	—	—	12177	12177	9-12-51
51 Dodge Coronet Clb Che	31848497	9-14-51	(11)	185354	—	—	—	—	—	—	10832	10832	9-14-51
51 Dodge Coronet 4-Door	31872104	10-25-51	(11)	207089	—	—	—	—	—	—	5769	5769	10-25-51
51 Ply Cranbrook Clb Che	15884443	10-29-51	(11)	151972	—	—	—	—	—	—	4237	4237	10-29-51
50 Dodge 1/2 Cnfy	82169852	6-30-50	(11)	114600	—	—	—	—	15927	38196	54123	6-30-50	7-1-50
51 Harley Davidson Tenn-las	5161158	10-1-50	(11)	116590	—	—	—	—	6498	38856	45354	10-1-50	10-1-50
51 Dodge Coronet 4-Door	31726011	4-25-51	(11)	193892	—	—	—	—	—	—	37727	37727	4-25-51

80009 / 217794 / 670745 / 146042 / 2456590 /

<u>Date Sold</u>	<u>Manner of Sale</u> Retail. Wholesale.	<u>Used by</u>	<u>Primary Purpose</u>	<u>Duration of Use</u>	<u>Registered</u>	<u>Insurance</u>	<u>Financed</u>
		Atlantic Discount Co.	lease	109	TITLE +		CASH
		"	lease	109	TITLE IN		TRANSACTION -
		"	lease	106	PROPERTY		FINANCED
		"	lease	107	NAME - NO		
	Vice President	"	lease	08	DEALER TAG		
	Atlantic Discount Co.	"	lease	109	6-1-3.		
	"	"	lease	110			
	"	"	lease	111			
	Mrs. W. W. Mauley	"	lease	112			
	President	"	lease	113			
	Mrs. W. W. Mauley	"	lease	114			
	Atlantic Discount Co.	"	lease	115			
		"	Parts + Service	116			
		"	Parts + Service	117			
	Gen Manager						

Covered by Standard Policy of Company
 Covered by General Liability

PRELIMINARY STATEMENT OF TOTAL TAX LIABILITY

YEAR	LIABILITY		PREVIOUSLY ASSESSED		ADJUSTMENTS PROPOSED THIS REPORT			
	Tax	Penalty	Tax	Penalty	Tax	Penalty	Def.	O/A
					Def.	O/A	Def.	O/A
INCOME TAX								
1950	\$119,394.58	- 0 -	116,381.55	- 0 -	3,012.99	- 0 -	- 0 -	- 0 -
1951	138,066.49	- 0 -	133,148.03	- 0 -	4,918.46	- 0 -	- 0 -	- 0 -
Total	257,461.07	- 0 -	249,529.58	- 0 -	7,931.45	- 0 -	- 0 -	- 0 -

Total								

Total								

Summary of Adjustments of Assessments Year 19

Income Tax				
Originally assessed - - - - -				
Deficiency assessed, 19__ - - -				
Overassessment scheduled, 19__ -				
Net Previous Assessments - - - -				

Year 19__

Originally assessed - - - - -				
Deficiency assessed, 19__ - - -				
Overassessment scheduled, 19__ -				
Net Previous Assessments - - - -				

Name of Taxpayer Massey Motors, Inc.

PRELIMINARY STATEMENT

Principal cause(s) of the additional tax liability is disallowance of depreciation on company cars and conversion of the gain reported thereon from capital gain to ordinary income per decision of the Tax Court of the United States in W. R. Stephens Company v. Commissioner of Internal Revenue, Docket No. 22681.

The findings have been discussed with Mr. W. W. Massey, President and counsel.

Was agreement procured? No. thirty-day letter requested.

Remarks: None.

TABLE OF CONTENTS

Pages 1 - 12, inclusive

Schedules 1 - 4A, inclusive

Exhibits A-B-C, inclusive

(Detailed index to be prepared where case justifies same)

Name Masssey Motors Inc. & Atlantic Motor Sales, Inc.

[fol. 163]

Schedule 1 Year 12/31/50
Period

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return	\$	278,197	87
As corrected		282,146	69
Net adjustment as computed below		3,948	82
Unallowable deductions and additional income:			
(a) Depreciation-company cars	\$	9,347	09
(b) Gain on sales of company cars		11,561	94
()			
()			
()			
()			
()			
TOTAL	\$	20,909	03
Nontaxable income and additional deductions:			
(a) Capital gain	\$	16,960	21
()			
()			
()			
()			
TOTAL	\$	16,960	21
Net adjustment as above		3,948	82

Name: Massey Motors, Inc.

Schedule: 1-A

Year 1950

Explanation of Items

(a) Depreciation-Company Cars

\$ 9,347.09

Depreciation on company cars has been reduced from the \$12,105.82 reported to \$ 2,758.73 as shown by Exhibit A. Except for the items of equipment shown therein, so called company cars are held to be stock-in-trade and not subject to allowance for depreciation.

(b) Gain on Sale of Company Cars

\$11,561.94

Gain of \$16,960.21 reported on sales of company cars has been reduced by the elimination of applicable depreciation in the amount of \$5,398.27 disallowed in (a) above, and resulting gain of \$11,561.94 is held to be ordinary gain.

(c) Capital Gain

\$16,960.21

Capital gain reported on sales of company cars has been eliminated in connection with adjustment (b), above.

[fol. 166]

Name Massey Motors Inc. & Atlantic Motor Sales, Inc.

Schedule 3 Year ended 12/31/51

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return \$ 267,661 93

As corrected 273,342 50

Net adjustment as computed below 5,680 57

Unallowable deductions and additional income:

(a) Depreciation - Company Cars	\$ 11,572	45
(b) Repossession expense	2,177	54
(c) Gain on sale of company cars	5,616	96
()		
()		
()		
()		
TOTAL	\$ 19,366	95

Nontaxable income and additional deductions:

(c) Capital Gain	\$ 13,686	38
()		
()		
()		
()		
TOTAL	\$ 13,686	38

Net adjustment as above 5,680 57

Name: Massey Motors, Inc. & Atlantic Motor Sales, Inc.

Schedule: 3-A

Year 1951

Explanation of Items

(a) Depreciation - Company Cars

\$ 11,572.45

Depreciation on company cars has been reduced from \$14,860.42 to \$3,287.97 as shown in Exhibit A.

(b) Repossession Reserve

\$ 2,177.54

Reserve of \$ 2,177.54 based on 3% of \$ 72,584.95 due from finance company is not properly excludible from income. Please see Section 43 of the Internal Revenue Code.

(c) Gain on Sale of Company Cars

\$ 5,616.96

Capital gain of \$15,926.69 reported on sales of company cars and leasehold has been decreased by the elimination of applicable depreciation in amounts of \$3,433.77 and \$4,635.65 disallowed in 1950 and 1951 and, except for gain shown per Exhibit A, is held to be ordinary income.

Capital Gain reported	\$15,926.69
Disallowed depreciation	8,069.42
Corrected gain	7,857.27
Less corrected capital gain-Exhibit A	2,240.31
Ordinary income	\$ 5,616.96

(d) Capital Gain

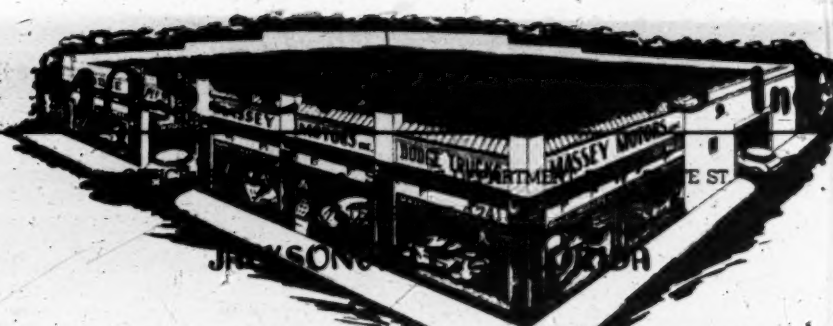
\$ 13,686.38

Except for gain of \$1,429.92 on sales of two trucks as shown by Exhibit A capital gain of \$15,116.30 reported on sales of company cars has been eliminated in connection with adjustment (c) above.

13,686.38
20,116.30
- 3,429.92
13,686.38



DODGE



PLYMOUTH

BREAKDOWN FOR MASSEY MOTORS, INC. AND ATLANTIC MOTOR SALES, INC.
SHOWING GROSS PROFITS BY EACH DEPARTMENT FOR 1950, 1951, 1952 &
1953

<u>MASSEY MOTORS, INC.</u>	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>
New Car Department	\$527,929.76	\$557,699.48	\$463,686.80	\$414,451.56
Used Car Department	154,221.60	179,117.47	187,893.79	235,279.50
Stockroom (Parts)	102,318.53	84,681.93	90,107.25	91,727.25
Service	122,443.49	122,383.12	111,091.73	93,965.61
Total Massey	\$598,470.18	\$585,647.06	\$476,991.99	\$364,864.92
<u>ATLANTIC MOTORS</u>				
New Car Department	\$231,632.17	\$310,407.59	\$240,111.40	\$229,593.15
Used Car Department	97,936.06	98,347.37	80,264.23	116,330.90
Stockroom (Parts)	18,592.85	22,980.82	20,408.39	25,310.27
Service	23,861.43	37,898.14	31,071.42	33,114.41
Total Atlantic	\$176,150.39	\$272,939.18	\$211,326.98	\$171,686.93
GRAND TOTAL MASSEY AND ATLANTIC	\$774,620.57	\$858,586.24	\$688,318.97	\$536,551.85

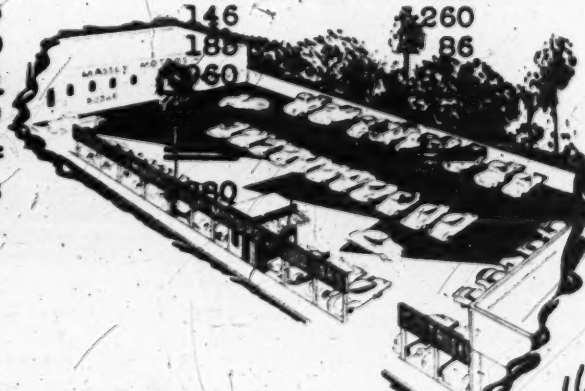
NUMBER OF NEW AND USED UNITS SOLD BY MASSEY MOTORS, INC. AND ATLANTIC
MOTOR SALES, INC. FOR THE SAME PERIOD.

<u>MASSEY MOTORS, INC.</u>	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>
New Dodge	778	682	624	518
New Plymouth	424	428	357	519
New Dodge Trucks	373	590	293	156
Used Units	1510	1479	1166	919
Total Massey	3085	3179	2440	2112

ATLANTIC MOTORS

New Dodge	280	306	249	221
New Plymouth	126	179	146	260
New Dodge Trucks	160	370	185	86
Used Units	548	1144	260	
Total Atlantic	1114	1999		

5178



11.8

LIBRARY
SUPREME COURT, U. S.

Office-Supreme Court, U. S.

FILED

JUN 24 1959

JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

October Term, 1958

No.

~~1027~~ 141

MASSEY MOTORS, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI
TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

JAMES P. HILL
816 Atlantic Bank Building
Jacksonville, Florida

JOHN A. RUSH
301 Florida Theatre Building
Jacksonville, Florida

WILLIAM R. FRAZIER &
816 Atlantic Bank Building
Jacksonville, Florida

Attorneys for Petitioner

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IN THE

Supreme Court of the United States

October Term, 1958

No.

MASSEY MOTORS, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI
TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled cause on February 26, 1959.

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court as amended are reported in 156 Fed. Supp. 516, and are also set forth in the record, pages 105 to 121, and pages 121 to 124. The opinion of the Court of Appeals is reported

at 264 Fed. 2d 552. (Appendix A, *infra*, p. 10).

JURISDICTION

The judgment of the Court of Appeals was entered on February 6, 1959. (Appendix B, *infra* p. 26). On May 22, 1959, the time for filing a petition for writ of certiorari was extended by order of Mr. Justice Black to and including July 13, 1959. (Appendix C, *infra*, p. 27). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether petitioner, a retail automobile dealer, is entitled to utilize a "useful life" of three years in computing depreciation with respect to certain company and rental cars used by it in the operation of its business and an estimated salvage value at the end of such three-year period in filing its Federal corporate income tax return for the calendar years 1950 and 1951:

STATUTE INVOLVED

The statutory provision involved is Section 23(1) of the Internal Revenue Code of 1939, which is set forth in Appendix D, *infra*, p. 28).

STATEMENT

The Petitioner is a Florida corporation with principal office at Jacksonville, Florida, and holds a franchise from Chrysler Corporation for the retail and wholesale sale of Plymouth and Dodge automobiles in Florida and Georgia.

Petitioner owned all of the issued and outstanding capital stock of Atlantic Motor Sales, Inc., which was located in Jacksonville and was also a franchise Chrysler dealer handling substantially the same products as those sold by Petitioner. For the taxable years in question, namely, the taxable years 1950 and 1951, Petitioner and its wholly-owned subsidiary filed a consolidated Federal income tax return.

Petitioner, during the years involved, employed between 85 and 120 persons in the operation of its business. The Petitioner also appointed associate dealers under an arrangement whereby merchandise was purchased from Chrysler and, in turn, sold to the associate dealers. Chrysler Corporation had no authority to sell merchandise directly to an associate dealer and its representatives had no authority to call on an associate dealer without a member of Petitioner's staff being present. During the taxable years, Petitioner had three associate dealers. Petitioner assisted its associate dealers in promotion work in connection with the sale of Chrysler automobiles, trucks and parts and, in general, supervised the operation of its associate dealers in much the same way that Chrysler supervised and directed its own retail dealers.

During the years involved, Petitioner's management withdrew certain automobiles from its inventory which were placed in company use.

Also, during the same years, Petitioner leased certain automobiles to Atlantic Discount Company, an automobile finance company, at a net rental of three cents per mile, payable monthly. During 1950, Petitioner had 51 company cars in service, of which 23 were leased to Atlantic Discount Company. The leased cars were used by company personnel of the finance company in the operation of its business.

In 1950, Petitioner sold 27 of the 51 company cars in service. During 1951, the taxpayer had 53 company cars, of which 26 were leased to Atlantic Discount Company. Petitioner sold 23 of these cars in 1951. Petitioner received rental income in the respective amounts of \$5,433.55 and \$7,288.22 during 1950 and 1951 from Atlantic Discount Company under the leasing arrangement. Atlantic Discount Company, Inc., paid all costs of operating and maintaining the leased vehicles, including the cost of all necessary collision and public liability insurance. During the taxable years, Petitioner incurred annual expenses of approximately \$5,000-\$6,000 in maintaining and operating its company cars.

Petitioner did not drive the new and used cars and trucks it held for retail sales to customers, except for necessary driving for servicing and delivery and these cars were not registered in its name under the Motor Vehicle Registration Laws of the State of Florida.

As a matter of bookkeeping procedure, Petitioner charged all cars and trucks it obtained from Chrysler Corporation into account No. 131 on its ledger. When any cars or trucks were placed in company use or in rental service, an entry was made to remove these vehicles from account No. 131, which was an inventory account, and to place them in the company car account, No. 167, a fixed asset account.

The decision to place cars in company or rental use was made by Petitioner's top management. As a car was placed in company use, it was covered with fire, theft, comprehensive public liability and property damage insurance for the exclusive benefit of Petitioner. Regular license plates were procured for each of the cars registered in Petitioner's name and the automobile was paid for in full in cash. Dealer tags

were never used on any of the cars employed for company business use.

The company cars were used by various of Petitioner's officials and its wholly-owned subsidiary, Atlantic Motor Sales, Inc., in the general course of everyday business, which included, among other things, traveling to and from the various locations maintained by both corporations. The cars were also used in making bank deposits, messenger service, trips to post office and for loan to customers in need of transportation. The cars were also used to permit managers and other company personnel to travel for business purposes to cities such as Atlanta, Georgia, and Tampa, Florida, for new car showings and other types of factory meetings. The cars were also used by taxpayer in its contact with associate dealers and used in various civic functions, such as parades, etc. Petitioner's business could not have operated successfully without the use of the company cars.

Petitioner followed the practice of disposing of all company and rental cars as soon after annual model change as was practicable. Petitioner's management deemed it advisable to have the company personnel in current model cars. Petitioner also disposed of its rental cars during the year the particular unit had run approximately 40,000 miles. Company cars were also removed from service when they had run approximately 10,000 miles, without regard to model change.

Petitioner, in filing its consolidated Federal income tax return for the calendar years 1950 and 1951, deducted the respective sums of \$9,346.69 and \$11,572.45 as depreciation on its company cars, including those rented to Atlantic Discount Company, Inc. It computed this depreciation on the straight line method, utilizing an estimated useful life of 36 months.

During the calendar year 1950, Petitioner sold 27 of the 51 company cars in use and under lease, of which 16 were held less than six months prior to date of sale. Petitioner reported a short-term capital gain in the amount of \$10,247.00 with respect thereto. The remaining 11 cars were held more than six months and Petitioner reported the long-term capital gain in the amount of \$6,713.21 with respect thereto, under the provisions of Section 117(j) of the Internal Revenue Code of 1939. During the calendar year 1951, Petitioner sold 23 of the 53 cars in company use and under rental, of which 9 were held less than six months. Petitioner reported a short-term capital gain in the amount of \$6,760.41 with respect thereto. Of the remaining 14 cars, depreciation and long-term capital gains treatment was allowed by the Commissioner as to two and they are not here in issue. The remaining 12 cars sold were held for more than six months prior to the date of sale and Petitioner reported a long-term capital gain in the amount of \$6,925.97 with respect thereto.

The Commissioner of Internal Revenue, in causing Petitioner's returns to be audited for the calendar years 1950 and 1951, determined that Petitioner was not entitled to any depreciation on the company cars in question, on the theory that all of the cars constituted stock in trade and were not therefore subject to an allowance for depreciation. Accordingly, the Commissioner also disallowed long-term capital gains treatment claimed under Section 117(j) with respect to the profits realized from the sale of the cars.

Following the audit, Petitioner paid the resulting deficiencies and interest in full, filed claims for refund within the time prescribed by law and in due course instituted a suit for refund in the District Court for the Southern District of Florida, Jacksonville Division, seeking an adjudication of its

liability for the deficiencies.

The examining agent also restored to income for the taxable year 1951 the sum of \$2,177.54, which Petitioner had excluded. The amount which Petitioner had excluded from its income for the year 1951, represented a portion of a finance company reserve holdback, which grew out of Petitioner's assignment of conditional sales contracts to the finance company, which company withheld a portion of the proceeds of sale in a reserve account in Petitioner's name.

The District Court held that Petitioner was entitled to the depreciation claimed on its returns for 1950 and 1951 and that the capital gains set forth thereon were taxable as long-term capital gains under Section 117(j) of the Internal Revenue Code of 1939.

The District Court also held that Petitioner had properly excluded a portion of its finance reserve holdback from income during the calendar year 1951.

Following the decision of the District Court, the respondent took an appeal to the Court of Appeals for the Fifth Circuit. The Court of Appeals, on February 26, 1959, in a split decision, reversed the District Court on the issue of depreciation and capital gains with respect to Petitioner's company and rental cars, and affirmed the District Court with respect to the finance holdback issue.

REASONS FOR GRANTING THE WRIT

1. The decision of the Court of Appeals is in direct conflict with the decision of the Court of Appeals for the Ninth Circuit in *Evans v. Commissioner*, 264 Fed. 2d 502, decided

January 26, 1959, with respect to the depreciation issue involved in this case. This conflict is expressly conceded and recognized by the Court of Appeals for the Fifth Circuit (Appendix A. p. 22 to 23).

2. A determination of the question involved by this Court is clearly in the public interest. It is obviously highly important in the present state of our economy operating under the burden of an extremely high Federal income tax structure, that taxpayers should be adequately advised as to the proper method of computing depreciation deductions for income tax purposes. The Court of Appeals, in the present case, has, in effect, held that in computing depreciation for Federal income tax purposes, each taxpayer is to utilize a useful life as determined by the history of use of a particular asset in its own business, as compared to utilizing a useful life which is inherent in the asset and would normally be used by taxpayers in general. The theory of the Court below adds another area of uncertainty, confusion and lack of objectivity in the administration and application of our Federal income tax statute.

Further in this connection, it is understood that the Office of the Solicitor General will not oppose the granting of this writ and will probably file a petition for a writ of certiorari in *Evans v. Commissioner* so as to bring this matter squarely before the Court.

3. The majority decision below is believed to be erroneous, and, as stated above, is in direct conflict with the decision of the Ninth Circuit in *Evans v. Commissioner*. The Ninth Circuit, in its opinion in the *Evans* case, referred to the decision of the District Court in the instant case with approval. We believe the Court of Appeals for the Ninth Circuit correctly

held that under Section 23(1) of the Internal Revenue Code of 1939, the language of the applicable Treasury regulations, Section 29.23(1), the consistent practice and position of the Commissioner over many years and the interpretation placed on the term "useful life" by decisions of the Tax Court extending over a long period, the useful life of a depreciable asset is its physical or economic life, as opposed to measuring such useful life by the period during which such asset was held in the business of a particular taxpayer.

CONCLUSION

For the foregoing reasons, it is submitted that this Petition for Writ of Certiorari should be granted.

Respectfully submitted,

JAMES P. HILL
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Attorneys for Petitioner

Dated June 19, 1959

APPENDIX A

**IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

No. 17279

UNITED STATES OF AMERICA,

Appellant,

versus

MASSEY MOTORS, INC.,

Appellee.

**Appeal from the United States District Court for the
Southern District of Florida**

(February 26, 1959.)

Before RIVES, TUTTLE and CAMERON, Circuit Judges.

TUTTLE, Circuit Judge: The United States in this appeal attacks the judgment of the trial court permitting the appellee taxpayer to take straight line depreciation figured on the entire useful life on certain company-used automobiles sold by the automobile dealer taxpayer after relatively short use by it generally for more than the original cost to the taxpayer.

Appellee is a franchised Chrysler dealer in Jacksonville, Florida. This case differs from *Duval Motor Company v. Commissioner of Internal Revenue*, 5 Cir., F. 2d., decided today in that on this appeal it is conceded by the government, following a finding to such effect by the trial court, that the automobiles here in issue were properly used in the trade or business of the taxpayer.¹

Massey Motors, Inc., a franchised Chrysler dealer, withdrew from the new cars bought by it during the calendar (and tax) years 1950 and 1951, 51 and 53 automobiles respectively. Of these it assigned approximately one half to its executives and other employees for transportation in connection with the company's business. The other half it rented to an unaffiliated finance company at a net rental of 3 cents a mile. From this rental operation it made a substantial net profit. The executives' cars were uniformly sold at the end of 8,000 to 10,000 miles use or the advent of new models, whichever was earlier. The rental cars were sold at the advent of new models or upon 40,000 miles of use. In nearly every instance the company used cars were sold at a substantial profit above the cost, and on the average the rented cars were likewise sold at a profit.² The taxpayer figured depreciation on all of

1 No salesmen's automobiles were involved in this case, and there was no evidence that any of these cars were used substantially for any purpose different than if they had been automobiles of a different make from those taxpayer was franchised to sell. On the undisputed facts of this record it seems to us that a respectable case might be made for the proposition that as a matter of law these automobiles sold within the same model year as when bought, and sold generally at a profit above original cost without allowance for depreciation, were held primarily for sale to customers in the ordinary course of taxpayer's business. Since the government does not urge this position, however, and since it is not argued here, we shall not deal further with it.

2 The executives' cars here in issue were sold for \$11,272.80 more than their cost and the rental cars were sold for \$525.89 more than they cost.

the cars on the straight-line basis with no allowance for salvage value. Gains on the sales were computed at capital gains rates with a basis of cost less depreciation.

The Commissioner disallowed the capital gains treatment of the gains and also disallowed the depreciation, contending that the automobiles were not property used in the trade or business under Section 117(j) of the Internal Revenue Code of 1939, because they were held primarily for sale to customers in the ordinary course of taxpayer's trade or business. The taxpayer paid the resulting deficiency and thereafter filed its claims for refund for the two years. The claims asserted that "the taxpayer contends that it is entitled to a reasonable allowance for depreciation as claimed on the aforementioned automobiles, constituting property used in the trade or business ... and that the gain realized by it on the sale of said automobiles is reportable as long term capital gain pursuant to the provisions, etc."³ Upon the disallowance of the claim the suit for refund was filed in the District Court.

The record discloses that the only evidence introduced below related to the business methods of the taxpayer touching on the use of company and rental cars and their subsequent sale, the essential parts of which are stated above, and testimony as to a small "reserve for repossessions," later discussed. No evidence was introduced on the depreciation issue apart from that relating to company practices. The trial court held in favor of the taxpayer on the capital gains treatment on the sale of the cars and also made a finding that the

³ This claim, which was of course made the basis of the subsequent suit, demonstrates the fallacy of appellee's contention here that the issue of depreciation was not separately raised in the trial court. Taxpayer put this matter in issue. Where the Commissioner makes a determination disallowing depreciation, the burden is on the taxpayer to prove the correctness of the depreciation claimed.

rate of depreciation, utilizing a 36-months estimated useful life without deducting any salvage value, was a reasonable and fair rate.

The government here attacks this finding and the court's conclusion that the claimed depreciation should be allowed. The thrust of its position is that depreciation must be figured with relation to the known useful life of the asset in the hands of the taxpayer rather than the entire useful life of the property itself; that depreciation cannot be figured without considering the salvage value at the end of the useful life in the hands of the taxpayer; that it was demonstrated here that the useful life in the hands of Massey Motors, Inc. was less than a year; and that the salvage value more than equaled original cost; thus the depreciation would be zero.

Taxpayer, to the contrary, asserts that whatever may have once been the meaning of useful life "and whatever meaning it may have under current Treasury Regulations promulgated following enactment of the 1954 Code, at the time here in question 'useful life' meant the whole useful life of the property itself without regard to the length of time it was intended by the taxpayer that it would be used by him; that the salvage value should properly be that value at the end of the life of the automobiles after they had served their total useful life in the hands of all owners; that total useful life of these automobiles was three years, and that no salvage value would remain thereafter." This is in effect what the trial court held. In light of the facts here that these cars, other than the rented cars, were used approximately 8,000 to 10,000 miles during the first year, and even in the case of the rented cars that they still had a value equaling their cost at the end of the first of the three years, such a holding is so contrary to our knowledge of the facts of life that it must

bear close scrutiny.

The statute provides simply that the taxpayer may take as a deduction under the heading of "Depreciation," "a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) (1) of property used in the trade or business."

² There is no real dispute between the parties here as to the meaning of the statutory terms. Conceptually depreciation is properly a deductible item because the natural wear and tear upon the capital items which a taxpayer uses to produce his income is a cost element in the production of income. The Supreme Court said in 1926:

"The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that at the end of the useful life of the plant in the business the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to original cost." (Emphasis added.) *United States v. Ludey*, 274 U.S. 295, 300, 301.

We think it clear that the words "of the plant" in this opinion refer to all depreciable assets alike, not only the fixed assets. Appellee here agrees in its brief that a salvage value must be determined before the application of straight line depreciation over a three year life.⁴ It is unfortunate that appellee did not "recognize" this principle when it submitted the case to the trial court rather than insist it was entitled

4 In its brief appellee states: "We readily recognize the fact that the cost of a business asset depreciated on the straight line method should first be reduced by the estimated salvage value before applying the rate of depreciation in accordance with the decision of the Supreme Court in *United States v. Ludley*, 274 U.S. 295."

to straight three years' depreciation, which it improperly deducted, contrary to all recognized accounting and legal principles, and thus induced so apparent an error in the judgment of the trial court.⁵ Taxpayer's brief concedes that if this question is properly before the court, as we have found it is, the case must be remanded to the trial court to permit it to prove the salvage value—an essential part of its case which it failed to prove on the first trial. It might be simpler for us to reverse the erroneous judgment thus induced by taxpayer and enter judgment dismissing this part of the appellee's suit for failure of proof. However, since we do not feel that substantial justice would be achieved without allowing an opportunity for taxpayer to furnish the proof necessary under the principles of law properly applicable to the case, we shall not give it that direction.

The principal difficulty in figuring depreciation on property of the kind here used is that it is quite doubtful that Congress ever intended that automobiles temporarily used by people in the business of selling automobiles should be subject to depreciation at all. See *Duval Motor Company v. Commissioner of Internal Revenue*, *supra*. As illustrated by the facts in this record, depreciation of \$347.93 on a company car, bought for \$2083.43, for a holding period of six and a half months, followed by a sale on a capital gains basis of \$2695.00 offends all ideas of the real purpose of allowing de-

⁵ Having filed its claim for refund on its assertion that "it is entitled to a reasonable allowance for depreciation as claimed on the aforementioned automobiles" (emphasis added) the taxpayer squarely assumed the burden of proving the reasonableness of the now conceded erroneous schedule. As pointed out above, there is no merit in taxpayer's contention that the court's finding in favor of this erroneous schedule is not properly before us for consideration.

preciation.⁶ Recognizing full well that tax effects on businesses are not always uniform and, more important, that the incidence of federal taxation is statutory and not always strictly equitable, or always logical, we think it quite appropriate to consider the apparently unintended result that follows from an asserted construction of the tax laws in performing our duty to construe the language of a statute.

The Tax Court, with the acquiescence of the Commissioner, in *Latimer-Looney Chevrolet Co., Inc. v. Commissioner*, *supra*, and the trial court in this case having held, without appeal on the part of the government, that cars such as these here in issue are properly used in the trade or business and are thus subject to depreciation, it now becomes necessary for us to apply the statute on depreciation with such light as can be gleaned from the Treasury Regulations and the Tax Court and trial and appellate court decisions.

Taxpayer urges that the construction it advances is consistent with that promulgated by the Commissioner himself, since in Regulations in effect during the tax years in question it is stated:

"The capital sums to be recovered shall be charged off over the useful life of the property, either in equal annual installments, or in accordance with any other recognized trade practice, such as an appointment of the capital sum over units of production." Treasury Reg. 702, Sec. 29.33 (1-5) 1939 Code.

⁶ As we roughly compute the tax savings, solely because of the use of depreciation on these company cars where they are accorded capital gains treatment on sale, the automobile mentioned above, instead of yielding Massey Motors a return after taxes, of \$250.38 on the suggested Chrysler mark-up of 25%, the automobile, after seven months' use by the company, would yield a return, after taxes, of \$550.34.

Taxpayer contrasts this with the language in corresponding regulations in existence prior to 1942, the date of the promulgation of the above quoted language. In point of fact, there is no change in the language in the corresponding sections which deal with "Method of computing depreciation." Both before and after 1942 the relevant language of this section of the Regulations was the same. See Section 27.23 (1-5) for 1939 and as amended on Dec. 8, 1942. The change in language in regulations under the depreciation section of the 1939 Code appears in Section 29.23(1-1). Prior to Dec. 8, 1942, this section, which in reality appears to be a definition section rather than a regulation telling how to compute depreciation, provided in essential part:

"A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the *useful life of the property in the business*, equal the cost or other basis of the property . . ." (Emphasis added.)

Taxpayer here seems to concede, as we think it must, that if this regulation had been in effect during the tax years here in issue, the useful life of the automobiles would be the life in the hands of the taxpayer. In fact we think the quoted language from *United States v. Ludey, supra*, is determinative of the matter. It clearly says the test is *the end of the useful*

life of the plant in the business.

Taxpayer points to a change in the amended regulations promulgated in 1942, as indicating change in the Commissioner's interpretation of the statute in this respect.

The corresponding language of the 1942 amended regulation is as follows:

"A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, *or treated under [Reg.] section 19.23 (a)-15 as held by the taxpayer for the production of income* may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the *depreciable property*, equal the cost or other basis of the property"

It will be apparent that in the last sentence the words "property in the business" has been eliminated and the words "depreciable property" substituted. A cursory look at the legislative history back of this amendment clearly demonstrates that there was no purpose to express a change in what was meant by useful life. This change was necessitated by an amendment in 1942 to the 1939 Code, which *added* as property entitled to depreciation "property held for the production of income." Thus the regulation which had theretofore dealt only with property used in the trade or business was

inadequate, and it had to be amended by the inclusion of the italicized words above. The last sentence could not, of course, thereafter adequately cover both classes of property by referring to "property in the business" because this would not include the new class "property held for the production of income." The language "depreciable property" would, of course, cover both, and it was substituted for "property in the business."

Thus, we think it clear that whatever was understood by the Treasury Department prior to 1942 by useful life remained unchanged by the amendments here discussed. Thereafter, when the 1954 Internal Revenue Code was adopted, without any change in the depreciation section of the law, the Treasury promulgated the Regulations under it. They expressly provide:

"Salvage value is the amount (determined at the time of acquisition) which is estimated will be realized upon sale or other disposition of an asset *when it is no longer useful in taxpayer's trade or business* or in the production of his income *and is to be retired by the taxpayer.*" (Emphasis added.)

It must be borne in mind that there has been no change in the basic statute in any matter here relevant during the entire period of time. We should thus be inclined to look with considerable disfavor on any contention that a slight change in Regulations worked such a double shift in the effect of a simple statute allowing reasonable depreciation. We do not think the Commissioner's Regulations could change the basic concept of depreciation from that announced by the Supreme Court in the Ludey case.

We are supported in our conclusion that there has been no

intent by the Commissioner to effect such a change by the further significant fact that prior to and after the 1942 change in Regulations, there was outstanding the Treasury's Bulletin F, universally recognized by all and sundry familiar with tax problems as representing the Treasury's theories as to the application of depreciation.⁷

This Bulletin includes the following language under the heading "Allowance for Depreciation and Obsolescence":

"The proper allowance for exhaustion, wear and tear, including obsolescence, of property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) whereby the aggregate of the amounts so set aside, plus the salvage value, will at the end of the useful life of the property *in the business*, equal the cost or other basis of the property." (Emphasis added.)

It will thus be seen that notwithstanding the change in Regulation Section 29.23 1-1 in December, 1942, no change has been made in Bulletin F which purports to show the "tendency of official opinion" in the Internal Revenue Service. It cannot well be said that the change above discussed was intended to, or did, change the meaning of useful life.

⁷ Of course, in its initial publication, the Internal Revenue Service was careful to disclaim any authoritative standing for the specific items treated within Bulletin F. Nevertheless, when it was republished in January, 1942, it stated:

"It contains information and statistical data relating to the determination of deductions for depreciation and obsolescence, from which taxpayer and their counsel may obtain the best available indication of Bureau practice and the trend and tendency of official opinion in the administration of pertinent provisions of prior Revenue Acts."

We conclude that as to a taxpayer so placed that his business experience has taught that automobiles, bought by him for sale but temporarily assigned for use in the business with use in the business averaging less than one third of their total usable life,⁸ such automobiles are depreciable by him on the basis of his expected use of the cars in his business and not on the basis of the length of time the car is expected to be usable as a passenger automobile.⁹

The statute allows a reasonable amount for depreciation. No regulation, although valid and binding to the extent it does not enlarge or conflict with the statute, can bind the Commissioner to the allowance of anything more than a reasonable deduction for a whole class of taxpayers. A construction of this regulation as contended for by this taxpayer would result in not only a grossly unreasonable deduction for depreciation, but would offend the basic concept of depreciation and its purpose. We, therefore, cannot approve a construction of the regulation that would reach this result, or if we did so, we would have to hold it invalid as to the factual situation here present as not being authorized by the statute.

As we have previously stated, the basic difficulty here arises

8 We have not here commented on the short life of three years here accepted by the trial court. Bulletin F, above referred to, suggests a life of business automobiles, upon the assumption that their entire life is to be a business one rather than for individual or family use, of five years for all except salesmen. It would seem quite unlikely that a useful life of three years for a passenger automobile used only 8,000 to 10,000 miles the first year would be sustainable even on the taxpayer's theory of the law upon a full development of the case. In any event the correct rate of depreciation is dependent upon proof. None was offered by the taxpayer to justify its taking this unrealistically short life without even providing for any salvage value.

9 For a clear and convincing discussion and analysis of this problem, leading the author to the same conclusion we have reached see Montgomery's Federal Taxes, 37th Edition, Chapter 6, page 4, et seq.

from the application of depreciation to a type of property held in such circumstances as would raise much doubt that they were considered as depreciable assets when the law was enacted. So long as taxpayers normally used their capital and other business property for the period of time that they had any substantial vitality left in them the regulations, construed either way, were satisfactory. But when, as here the courts, over the commissioner's opposition, gave Section 117(j) treatment including the right to depreciation, to property used as were these automobiles, it cannot, we think, be said that the Commissioner is bound to his construction of the regulations published under different circumstances, and especially when he consistently took the position that the depreciation regulations did not apply here at all. When he lost that argument he then issued new regulations which do precisely cover this type of property as used here. In doing so he did not intend to and did not—he *could* not—change the law. For us to hold that the new regulations of 1956 had the effect of defining useful life as useful life in the business for the first time would amount to our saying that the Commissioner could by Regulations change the law.

We realize that this conclusion brings us to a different result from that reached by the Court of Appeals for the Ninth Circuit in *Evans v. Commissioner of Internal Revenue*, 9 Cir., . . . F. 2d. . . . dec. Jan. 26, 1959, which has been brought to our attention after argument. With deference, we think that decision, reached after a well-reasoned and painstaking analysis, too greatly emphasizes the Regulations as portraying the Commissioner's position. In effect it says that there is no shifting back and forth by the Commissioner on this construction; but that he has always construed useful life as the total life of usefulness and that he is bound by this consistent practice. There is much to be said for the

proposition that taxpayers have a right to rely on the clearly announced construction placed on the laws by the administrative officials whose duty it is to write the regulations and apply them administratively. This is well stated by the excellent opinions in the Evans case. But we feel that that court has overlooked the essential point that all the time these regulations were in effect the Commissioner was making known by litigating everywhere his position that these regulations were not applicable here, no matter how they were construed because he was contending that these were not depreciable assets at all. Under these circumstances, it could not be said that a taxpayer, so circumstanced as Massey Motors, Inc., could rely on the Treasury's position as saying that he could use the combination of capital gains treatment with depreciation deductions to double its profits after taxes on the sale of such assets. So long as the Commissioner was proclaiming at every opportunity that the depreciation regulation did not apply to this situation at all, it cannot be said that he is bound by language which took on no real significance until the courts held against him on his contention. Thereafter he is free, it seems to us, to argue a construction of the regulations that carries out the intent of the statute rather than being bound by one which frustrates it.

The government contends that as a necessary corollary to our conclusion we should find that on the record here the salvage value at the end of this useful life, approximating one year, exceeds cost, and that no depreciation can be taken at all. We think that the attention of the trial court and both parties was so concentrated on the legal principle that too little attention was paid to the fact issue: what would be a reasonable allowance for depreciation under the principles of law here laid down? Without argument touching the point we should not decide for instance whether salvage value

should be the value of the company cars at retail, since that is how they are sold, or whether, since much of the value of the cars in the hands of this taxpayer results from the fact that it is a large buyer and seller of automobiles, the salvage value should be on the wholesale market, since that is the market on which it buys them. We think these matters must be developed on a new trial, which can be limited to such issues as are here discussed without retrying the other issue on which the government does not appeal.

As to the remaining point in the case, the right of the taxpayer to deduct from income for 1951 a small reserve called "Reserve for Repossessions," the parties agree that the same issue has recently been decided by this Court against the government in *Texas Trailercoach, Inc. v. Commissioner*, 5 Cir., 251 F. 2d 395, and also by other Courts of Appeals in *Johnson v. Commissioner*, 4 Cir., 233 F. 2d 952, *Glover v. Commissioner*, 253 F. 2d 735, *Hansen v. Commissioner*, 9 Cir., F. . . . We think we are bound by those decisions and therefore affirm the action of the trial court touching on this issue. Of course, no final judgment will be entered in the trial court immediately, and in the event the Supreme Court on certiorari already filed decides contrary to our views, the trial court can and should give effect to its decision.

Judgment REVERSED for further proceedings not incon-

sistent with this opinion.

CAMERON, Circuit Judge: I dissent.

A true copy

Test: EDWARD W. WADSWORTH
Clerk, U. S. Court of Appeals, Fifth Circuit

By Clara R. James,
Deputy

New Orleans, Louisiana

March 5, 1959

APPENDIX B

JUDGMENT

Extract from the Minutes of February 26, 1959.

UNITED STATES OF AMERICA,

No. 17279.

versus

MASSEY MOTORS, INC.

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed for further proceedings not inconsistent with the opinion of this Court.

"Cameron, Circuit Judge, dissenting."

APPENDIX C

SUPREME COURT OF THE UNITED STATES

No. _____, October Term, 1958

MASSEY MOTORS, INC.,

Petitioner,

vs.

UNITED STATES OF AMERICA

Order Extending Time to File Petition for
Writ of Certiorari

UPON CONSIDERATION of the application of counsel for
petitioner(s),

IT IS ORDERED that the time for filing petition for writ of
certiorari in the above-entitled cause be, and the same is here-
by, extended to and including July 13, 1959.

(S) HUGO L. BLACK

Associate Justice of the Supreme
Court of the United States

Dated this 22 day of May, 1959.

APPENDIX D

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(1) Depreciation. — A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)

(1) of property used in the trade or business, or

(2) of property held for the production of income. In the case of property held by one person for life with remainder to another person the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each.

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PA. 141

AMERICAN BANKING CORP.

Department of the United States

Internal Security, 1958

AMERICAN BANKING CORP., DEFENDANT

UNITED STATES OF AMERICA

**IN COMPLIANCE WITH THE PROVISIONS OF THE
INTERNAL SECURITY ACT OF 1950**

UNITED STATES OF AMERICA

AND BARRON
Attorneys at Law
Washington 25, D. C.

In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 141

MASSEY MOTORS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE
FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

The issue presented in this case is the same as that in *Commissioner of Internal Revenue v. Robley H. Evans, et al.*, No. 143, this Term, pending on petition for writ of certiorari. The decision of the Court of Appeals for the Ninth Circuit in *Evans* is in direct conflict with that of the Court of Appeals for the Fifth Circuit here.

Subsequent to the filing of the petitions for certiorari in both the *Evans* and *Massey* cases, the Court of Appeals for the Third Circuit passed on the basic issue presented here, under the 1954 Code, in the case

of *Hertz Corporation v. United States*, decided July 6, 1959: The Third Circuit there stated that, both under and prior to the 1954 Code, "the accepted meaning of the term useful life ~~has~~ always been the period of usefulness of the asset to the taxpayer in his business". The opinion of the Third Circuit in the *Hertz* case is set forth as an appendix to this memorandum.

Thus, there is now a clear and acknowledged conflict of decisions between the Ninth Circuit, on the one hand, and the Fifth and Third Circuits, on the other. For the reasons more fully set forth in the petition for certiorari in *Evans*, the Government believes that the issue is of substantial and continuing importance and, accordingly, agrees that review by this Court is warranted and that the petition for certiorari should be granted in the instant case.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.

JULY 1959.

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 12,799

THE HERTZ CORPORATION, A CORPORATION
(SUCCESSOR BY MERGER TO J. FRANK CONNOR, INC.,
A CORPORATION),

v.

UNITED STATES OF AMERICA,
Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF DELAWARE

Before KALODNER, STALEY, and HASTIE, *Circuit
Judges.*

OPINION OF THE COURT

(Filed July 6, 1959)

By STALEY, *Circuit Judge.*

Essentially this appeal presents two questions for review, namely: (1) whether "useful life" for depreciation purposes as used in Section 167(c) of the Internal Revenue Code of 1954 means the physical life of an asset for business purposes (the economic life),

or the period during which the property is useful to the taxpayer; and (2) whether in the declining balance method of depreciation,¹ authorized by Section 167(b) (2) of the 1954 Code, salvage value is inherent in the method or, rather, is a figure below which depreciation is not permitted.

This is an action for refund of income taxes paid by appellee² for the fiscal years ended March 31, 1954, 1955, and 1956, in the amounts of \$100.15; \$4,044.54, and \$10,416.43, respectively. The government has appealed from an adverse judgment rendered by the District Court for the District of Delaware.³

Appellee's predecessor, Connor, was organized as a New Jersey corporation on April 2, 1947, and was merged with it on July 5, 1956. During the years pertinent to the inquiry, Connor was engaged in the business of renting and leasing automobiles and trucks, without drivers, in the State of New Jersey.⁴

¹ Under the declining balance method of depreciation, a uniform rate is applied each year to the unrecovered cost or other basis of the property; however, such rate may not exceed twice the appropriate straight line rate computed without adjustment for salvage, nor may it be applied to property with a useful life of less than three years. Under the straight line method of depreciation, the cost or other basis of the property less its estimated salvage value is deductible in equal amounts over the period of the estimated useful life of the property. Income Tax Regulations (1954 Code) § 1.167(b)-1 & 2.

² The Hertz Corporation is the successor by merger to J. Frank Connor, Inc., the original taxpayer herein. The claims for refund were filed by Hertz after such merger.

³ The opinion of the district court is reported at 165 F. Supp. 261 (D.C. Del. 1958).

⁴ "Renting" is the term used in the industry to describe the hiring of vehicles by salesmen, executives, engineers and

The taxpayer had in operation during this period a preventive maintenance program which called for periodic inspections and servicing. However, the operative condition of the vehicles was a relatively minor factor influencing replacement of the fleet. More important in this regard was the percentage of its fleet being operated regularly; the activities of its competitors; mechanical changes; climatic conditions; strikes and work stoppages; the ability to obtain new cars; whether the country was at war or peace; economic conditions in its business area; and its financial situation. None of these factors were predictable in advance.

Under the influence of these factors the holding period of appellee's cars and trucks varied considerably. The average holding period for automobiles during the 1954-1956 period was 26.17 months, and during its entire nine-year existence, 29.36 months. The corresponding average holding periods for trucks were 38.89 months and 48.26 months.

The president of the Hertz Corporation testified concerning the car rental industry, its relative youth, highly competitive nature, and the factors that influence replacement of the vehicles. Hertz owns and operates a car rental business in approximately 170 cities and licenses operations in 650 additional cities.

Appellee also presented evidence by three certified public accountants to the effect that the term "useful life" has consistently meant and still means the economic life of the asset and not the life of the asset in the hands of the taxpayer. They further indicated that their experience with representatives of the In-

tourists at stipulated rates per mile, per hour or day. "Leasing" is the term used to describe the contract hiring of vehicles for a fixed period on a relatively long-term basis (i.e., by the year or for a longer period).

ternal Revenue Service had been that depreciation was computed on the basis of the aggregate business life of the asset regardless of changes of ownership.

Initially, in preparing its returns for the years ended March 31, 1954, March 31, 1955, and March 31, 1956, appellee claimed depreciation on its automobiles on the basis of a four-year useful life at a 30% rate for the first two years and a 20% rate for the remaining two years. Its heavy duty trucks were depreciated on the basis of a five-year useful life, and its other trucks on the basis of a four-year useful life, both at uniform rates. The taxes so computed were paid. Subsequently, on September 14, 1956, appellee filed claims for refunds for the years 1954 and 1955, and on September 17, 1956, filed a claim for 1956. These claims for refund were based on an election in accordance with Section 1.167(c)-1(c) of the Treasury Regulations issued under the Internal Revenue Code of 1954 to utilize the declining balance method of depreciation. Inasmuch as the Commissioner failed to take any action upon the claims within a period of six months, this suit for refund was instituted.

The district court found that by 1954 the term "useful life" had come to mean the entire physical life (economic life) of the asset in question; that in enacting the Internal Revenue Code of 1954 Congress intended to change its meaning to useful life of the asset to the taxpayer; that Section 1.167(a)-1(b) of the Treasury Regulations so defining useful life was valid; that inasmuch as the Commissioner had acquiesced in the economic life construction of the term useful life, the appellee was entitled to rely thereon and the regulations could not be applied retroactively; and finally that salvage value is inherent in the declining balance method of depreciation and therefore there is no authority for application of a limit (rep-

representing reasonable salvage value) below which assets may not be depreciated. Accordingly, the district court entered judgment for Hertz for the total sum of \$14,367.32.

The initial question posed for our consideration relates to the meaning to be ascribed to the term useful life which first appeared in the tax statutes in Section 167(c) of the 1954 Code, limiting the use of the declining balance method of depreciation to property with a useful life in excess of three years. The term was not defined therein. At a much earlier date, however, the term became embedded in the tax regulations relative to depreciation. Accordingly, it is essential for us to consider the history of the various depreciation provisions and the regulations implementing them.

The basic depreciation provision contained in the Revenue Act of 1913, 38 Stat. 114,⁵ has remained substantially unchanged throughout all later enactments. Later enactments added provisions regarding obsolescence and incorporated "property held for the production of income" within the purview of depreciable property. However, the theory of depreciation is the same today as it was in 1927 when the Supreme Court considered the problem in *United States v. Ludey*, 274 U.S. 295, 300-301:

" * * * The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the

⁵ " * * * a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in business * * * "

salvage value) suffice to provide an amount equal to the original cost."

The regulations issued by the Commissioner throughout the history of the income tax have implemented this broad statutory scheme and therein first appeared the term useful life. Prior to issuance of the 1956 regulations, however, no definition of this term was incorporated therein.

Since it is hornbook law that in interpreting undefined statutory language the courts look to common usage and general acceptance, both parties to this action have diligently searched the history of the term. However, as is not uncommon, they came to different conclusions. The government contends that the term useful life means and has always meant the period during which the asset is of use to the taxpayer, while Hertz asserts that it has always meant the economic life of the asset. Thus, neither party supports the opinion of the district court that until 1954 and the enactment of the new Internal Revenue Code the term meant economic life of the asset but Congress changed its meaning in enacting the new code. On the contrary, the parties agree that the meaning of the term, whatever it may be, has remained unchanged throughout the period of its use; i.e., that the 1954 Code was not intended to nor did it change the meaning. Our consideration of the 1954 enactment convinces us that the parties are correct and that Congress in 1954 intended no change in the meaning of the term. The view we take of the case thus requires us to consider the contentions of the parties regarding the accepted meaning of useful life.

Thorough study of the references points up one undisputed fact; that is, few of the cases, treatises, or regulations have addressed themselves to this very problem. The language found therein is imprecise,

unclear, and ambiguous as regards the term useful life. Until the enactment of the 1954 Code and the authorization of the declining balance method of depreciation for assets with a three-year useful life, the problems regarding depreciation involved the reasonableness of the period of useful life. Few, if any, gave a thorough consideration to whether useful life meant economic life or not; rather, most taxpayers were interested in short depreciation periods. Further, most depreciable assets were such as were held by the taxpayer until they were ready to be scrapped and disposed of as no longer useful for their intended purpose.

Hertz's argument in support of the proposition that useful life has always meant the economic life of an asset is basically three-pronged; judicial interpretation, administrative practice, and expert opinion. As regards judicial interpretation—we have been cited to a number of Board of Tax Appeals and Tax Court decisions.⁶ However, the issue was not squarely presented nor was any theory of useful life formulated therein; rather, the questions posed in the cases were treated as factual in nature. Thus they are of little, if any, use to us as precedents. It was also noted that *Philber Equipment Corp. v. Commissioner of Internal Revenue*, 237 F.2d 129 (C.A. 3, 1956), utilized the term useful life in the sense contended for by Hertz.

⁶ *West Virginia and Pennsylvania Coal & Coke Co.*, 1 B.T.A. 790 (1925); *J. R. James*, 2 B.T.A. 1071 (1925); *Merkle Broom Co.*, 3 B.T.A. 1084 (1926); *Max Kurtz*, 8 B.T.A. 679 (1927); *Whitman-Douglas Co.*, 8 B.T.A. 694 (1927); *Wallace G. Kay*, 10 B.T.A. 534 (1928); *Sanford Cotton Mills*, 14 B.T.A. 1210 (1929); *John A. Maguire Estate, Ltd.*, 17 B.T.A. 394 (1929); *W. N. Foster*, 2 T.C.M. 595 (1943); *Nat Lewis*, 13 T.C.M. 1167 (1954); and *Pilot Freight Carriers, Inc.*, 15 T.C.M. 1027 (1956).

However, a close reading of that opinion indicates that its use of the term may well support either contention. Moreover, the use of the term was not essential to the holding nor was that issue litigated on appeal. Finally, we note two recent appellate opinions in which this very question was presented. In *Evans v. Commissioner of Internal Revenue*, 264 F.2d 502 (C.A. 9, 1959), the Ninth Circuit found in favor of the contention that useful life has always meant economic life, while in *United States v. Massey Motors, Inc.*, 264 F.2d 552 (C.A. 5, 1959), the Fifth Circuit came to the conclusion that it has consistently meant the length of time the assets are expected to be usable to the taxpayer. See also *Cohn v. United States*, 259 F.2d 371 (C.A. 6, 1958).

In regard to the administrative practice, it is only fair to note that some of the pronouncements are ambiguous. However, Hertz itself refers us to what we are convinced is a highly significant statement of Bureau position; i.e., Treasury Department Bulletin F. The following statement appears under the heading "Allowance for Depreciation and Obsolescence."

"* * * The proper allowance for exhaustion, wear and tear, including obsolescence, of property used in trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property *in the business*, equal the cost or other basis of the property." (Emphasis added.)

Although the Internal Revenue Service originally disclaimed any authoritative standing for the specific items treated in Bulletin F, when it was republished in January, 1942, the following was added:

“* * * It contains information and statistical data relating to the determination of deductions for depreciation and obsolescence, from which taxpayers and their counsel may obtain the *best available indication of Bureau practice* and the trend and tendency of official opinion in the administration of pertinent provisions of the Internal Revenue Code and corresponding or similar provisions of prior Revenue Acts.” (Emphasis added.)

Finally, Hertz relies upon the expert opinion of three witnesses, partners in the accounting firms of Ernst & Ernst, Price Waterhouse & Co., and Arthur Andersen & Co., respectively. They were called “to give testimony with respect to their experience in the application of the depreciation provisions of prior revenue acts, and specifically, to give their opinion as to the meaning of the term ‘useful life’ as it is consistently used and understood for the purposes of depreciation.” Whatever persuasiveness this testimony might have is lessened when it is noted that Montgomery’s Federal Taxes, 37th ed., 1958, ch. 6, p. 4 et seq., edited by four partners in the accounting firm of Lybrand, Ross, Bros. & Montgomery, is directly to the contrary.

Among the other evidence relied upon by Hertz is the fact that in 1942 the depreciation regulations were significantly changed. Prior to December 8, 1942, Section 19.23(l)-1 provided an allowance for depreciation which “plus the salvage value, will, at the end of the *useful life of the property in the business*, equal the cost or other basis of the property * * *.” (Emphasis added.) The 1942 regulation eliminated the words “property in the business” and substituted the words “depreciable property.” Although this change might appear to support Hertz’s position on a cursory

glance, a study of the legislative history of the amendment indicates that the change was effected as a result of the amendment of the act so as to include property held for the production of income within the class of depreciable property. No other significance for the change is warranted. See *United States v. Massey Motors, Inc.*, 264 F.2d 552 (C.A. 5, 1959).

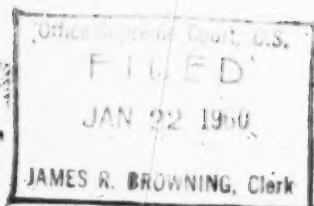
We are of the opinion that the accepted meaning of the term useful life has always been the period of usefulness of the asset to the taxpayer in his business. Such a conclusion is in accord with the fundamental concept of depreciation as set forth in *United States v. Ludey*, 274 U.S. 295 (1927), as further enunciated in Bulletin F, and as adhered to by the appellate courts. *United States v. Massey Motors, Inc.*, supra; *Cohn v. United States*, 259 F.2d 371 (C.A. 6, 1958). Nothing in the legislative history of the 1954 Code leads us to a contrary conclusion; rather, if anything, it supports the view here expressed and indicates, as the district court noted, that Congress was using the term useful life to mean the period during which an asset is useful to a taxpayer. Therefore, since the automobiles in question had a useful life of less than three years, Hertz is not entitled to depreciate them under the declining balance method of depreciation.

The question concerning the proper application of salvage value to the declining balance method of depreciation need not detain us for long. Congress unmistakably indicated in 1954 when it first authorized the new method of depreciation that "The changes made by your committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to a property." H. Com. Report on H.R. 8300, 83d Cong., 2d Sess., 3 U.S. Code Cong. & Adm. News 4017, 4049 (1954). Thus,

what is changed is the acceleration of depreciation deductions in earlier years but not the total amount of such deductions. We can find no support for Hertz's contention that, since it is theoretically impossible to ever depreciate the entire value of the asset under this system, Congress intended that a taxpayer should be allowed to use the declining balance method to depreciate the asset below a reasonable salvage value. On the contrary, the statement quoted above appears to directly contradict such an assertion. The gist of Hertz's oral argument on this issue is that Congress intended to encourage replacement of equipment through a liberalized depreciation method more in accord with economic realities; that the treatment or lack of treatment of salvage value would also encourage that end by giving a tax benefit to the taxpayer; therefore, Congress must have intended that salvage value not be a limit upon depreciation under the declining balance method. The argument, if it has any validity, should be addressed to the Congress and not to the courts, especially in view of the clear and precise intention of Congress manifested in its committee reports.

The judgment will be reversed.

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SUPREME COURT. U. S.



In the United States Supreme Court

OCTOBER TERM, 1959

No. 141

MASSEY MOTORS, INC., Petitioner

v.

THE UNITED STATES OF AMERICA, Respondent.

**On Writ of Certiorari to the Court of Appeals
for the Fifth Circuit**

BRIEF FOR MASSEY MOTORS, INC., PETITIONER.

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APPENDIX

Appendix A:

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In the United States Supreme Court**OCTOBER TERM, 1959**

No. 141**MASSEY MOTORS, INC., Petitioner****v.****THE UNITED STATES OF AMERICA, Respondent.**

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BRIEF FOR MASSEY MOTORS, INC., PETITIONER

OPINIONS BELOW

The opinion of the United States Court of Appeals (R. 132-144) is reported at 264 F.2d 929. The Findings of Fact and Conclusions of Law, as amended, of the District Court are reported in 156 F.Supp. 516.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1959 (R. 144). On June 24, 1959, an order granting the petition for certiorari was entered, and the case transferred to the summary calendar. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

This income tax case involves a question of the proper definition of the terms "useful life" and "salvage value" for purposes of computing allowances for depreciation under Section 23(1) of the Internal Revenue Code of 1939. The petitioner, a retail automobile dealer, in filing its Federal income tax returns for the calendar years 1950 and 1951 claimed depreciation deductions with respect to certain company and rental cars used by it in the operation of its business, computing such deduction on a straight line method, with a "useful life" of three years, without consideration of any salvage value. The Government contends that the useful life of the vehicles in question is their useful life as shown by the business practices of the petitioner, and not their physical or economic life and that the salvage value of the vehicles is equal to their sales price when removed from service. The petitioner on the other hand contends that the useful life of the cars for purposes of computing an allowance for depreciation for Federal income tax purposes under the Internal Revenue Code of 1939 is the economic or physical life of such vehicles and that the salvage value, if any, properly assignable is the value of the cars at the end of such economic or physical useful life.

Hence, in this case, the Court is called upon to settle the question of the proper definition of the terms "useful life"

and "salvage value" for purposes of computing depreciation deductions under Section 23(1) of the Internal Revenue Code of 1939.

STATUTE AND REGULATIONS INVOLVED

Section 23(1) and Section 117(j) of the Internal Revenue Code of 1939 and the relevant portions of Treasury Regulations 111 are set forth in Appendix A, *infra*, pages 36-40.

STATEMENT

The facts involved in this case as found by the Courts below (R. 105-117; 121-124; 132-144) are summarized below.

The petitioner is a Florida corporation with principal office at Jacksonville, Florida, and holds a franchise from Chrysler Corporation for the retail and wholesale sale of Plymouth and Dodge automobiles in Florida and Georgia.

Petitioner owned all of the issued and outstanding capital stock of Atlantic Motor Sales, Inc., a corporation which was located in Jacksonville, and was also a franchised Chrysler dealer handling substantially the same products as those sold by petitioner. For the taxable years in question; namely, the calendar years 1950 and 1951, petitioner and its wholly-owned subsidiary filed a consolidated Federal income tax return.

Petitioner, during the years involved, employed between 85 and 120 persons in the operation of its business. The petitioner also appointed associate dealers under an arrangement whereby merchandise was purchased from Chrysler and, in turn, sold to associate dealers. During the taxable years in question, petitioner had three associate dealers. Petitioner assisted

its associate dealers in promotion work in connection with the sale of Chrysler automobiles, trucks and parts, and in general supervised the operation of its associate dealers in much the same way that Chrysler supervised and directed its own retail dealers.

During the years involved, petitioner's management withdrew certain automobiles from its inventory which were placed in company use.

During the same years, petitioner leased certain automobiles to Atlantic Discount Company, an automobile finance company, at a net rental of 3 cents per mile, payable monthly. During 1950, petitioner had 51 company cars in service, of which 23 were leased to Atlantic Discount Company. The leased cars were used by company personnel of the finance company in the operation of its business.

In 1950, petitioner sold 27 of the 51 company cars in service. During 1951, the petitioner had 53 company cars, of which 26 were leased to Atlantic Discount Company. Petitioner sold 23 of these cars in 1951. Petitioner received rental income in the respective amounts of \$5,433.55 and \$7,288.22 during 1950 and 1951 from Atlantic Discount Company under the leasing arrangement. Atlantic Discount Company paid all costs of operating and maintaining the leased vehicles, including the cost of all necessary collision and public liability insurance. During the taxable years, petitioner incurred annual expenses of approximately \$5,000 to \$6,000 in maintaining and operating its company cars.

The petitioner did not drive the new and used cars and trucks it held for retail sales to customers, except for necessary driving for servicing and delivery, and these vehicles

were not registered in its name under the Motor Vehicle Registration laws of the State of Florida.

As a matter of bookkeeping procedure, the petitioner charged all cars and trucks it obtained from Chrysler Corporation into Account No. 131 on its ledger. When any cars or trucks were placed in use or rental service, an entry was made to remove these vehicles from Account No. 131, which was an inventory account, and to place them in the company car Account No. 167, a fixed asset account.

The decision to place cars in company or rental use was made by petitioner's management. As a car was placed in company use, it was covered with fire and theft, comprehensive, public liability and property damage insurance, for the exclusive benefit of petitioner. Regular license plates were procured for each of the cars registered in petitioner's name, and the automobile was paid for in full in cash. Dealer tags were never used on any of the cars employed for company business uses. The company cars were used by various of petitioner's officials and its wholly-owned subsidiary, Atlantic Motor Sales, Inc., in the general course of everyday business, which included, among other things, traveling to and from the various locations maintained by both companies. The cars were also used in making bank deposits, messenger service, trips to postoffice, and for loan to customers in need of transportation. The cars were also used to permit managers and other company personnel to travel for business purposes to cities, such as Atlanta, Georgia, and Tampa, Florida, for new car showings and other type of factory meetings. The cars were also used by the petitioner in its contact with associate dealers and used in various civic functions, such as parades, etc. Petitioner's business could not have operated successfully without the use of the company cars.

Petitioner followed the practice of disposing of all company and rental cars as soon after annual model change as practicable. Petitioner's management deemed it advisable to have the company personnel in current model cars. Petitioner also disposed of its rental cars during any year that a particular unit had run approximately 40,000 miles. Company cars were also removed from service when they had run approximately 10,000 miles, without regard to model change.

Petitioner, in filing its consolidated Federal income tax returns for the calendar years 1950 and 1951, deducted the respective sums of \$9,346.69 and \$11,572.45 as depreciation on its company cars, including those rented to Atlantic Discount Company. It computed this depreciation on a straight line method utilizing an estimated useful life of 36 months, and no salvage value.

During the calendar year 1950, petitioner sold 27 of the 51 company cars in use and under lease, of which 16 were held less than six months prior to the date of sale. Petitioner reported a short-term capital gain in the amount of \$10,247.00 with respect thereto. The remaining eleven cars were held more than six months, and petitioner reported long-term capital gain in the amount of \$6,713.21 with respect thereto under the provisions of Section 117(j) of the Internal Revenue Code of 1939. During the calendar year 1951, petitioner sold 23 of the 53 cars in company use and under rental, of which nine were held less than six months. Petitioner reported a short-term capital gain in the amount of \$6,760.41 with respect thereto. Of the remaining 14 cars, depreciation and long-term capital gains treatment was allowed by the Commissioner as to two, and they are not here in issue. The remaining 12 cars sold were held for more than six months prior to the date of sale, and petitioner reported long-term capital

gain in the amount of \$6,925.97 with respect thereto.

The Commissioner of Internal Revenue in causing petitioner's returns to be audited for the calendar years 1950 and 1951 determined that petitioner was not entitled to any depreciation on the company cars in question on the theory that all of the cars constituted stock in trade and were not therefore subject to an allowance for depreciation, and accordingly, the Commissioner disallowed long-term capital gains treatment under Section 117(j) with respect to the profits realized from the sale of these cars. Following the audit, petitioner paid the resulting deficiencies and interest in full, filed claims for refund within the time prescribed by law, and in due course instituted a suit for refund in the District Court for the Southern District of Florida, Jacksonville Division, seeking an adjudication of its liability for the deficiencies.

The District Court held that the cars in question were bona fide used in the operation of the petitioner's trade or business and that, therefore, the gains realized from the sale of the units held for more than six months qualified for long-term capital gains treatment under Section 117(j) of the Internal Revenue Code of 1939.

The District Court also held that petitioner was entitled to the depreciation claimed on its original returns for 1950 and 1951.

Following the decision of the District Court, the Government took an appeal to the Court of Appeals for the Fifth Circuit. The Court of Appeals on February 26, 1959, in a split decision, reversed the District Court on the issue of depreciation and capital gains with respect to petitioner's company and rental cars.

The Court of Appeals, in effect, held that the useful life to be used for purposes of computing deductions for depreciation is the useful life of assets used in trade or business as shown by the trade practices of a particular taxpayer, with salvage value to be calculated at the end of such period, as opposed to utilizing as the useful life the inherent economic or physical life of the asset. The case was remanded to the District Court for a determination of the proper salvage value to be assigned to the vehicles in question.

SUMMARY OF ARGUMENT

The decision of the Fifth Circuit attacked in this Court holds that for Federal income tax purposes in computing deductions for depreciation under Section 23(1) of the 1939 Code, the term "useful life" of a fixed asset used in business means the useful life of the asset in the hands of a particular taxpayer and not its physical or economic life and that "salvage value" must be considered at the end of such period. We submit that the decision is erroneous for the following reasons:

I.

For purposes of computing depreciation with respect to property used in trade or business under Section 23(1) of the Internal Revenue Code of 1939 on the straight line method, the useful life to be used is the physical or economic life of such asset and its salvage value, if any, is to be determined as of the end of such physical or economic useful life. In this contention, we believe that the Court of Appeals for the Ninth Circuit in *Evans v. Commissioner*, 264 F.2d 502, correctly held that under Section 23(1) of the Internal Revenue

Code of 1939, the language of applicable Treasury regulations, the consistent practice and position of the Commissioner over many years and the interpretation placed on the term "useful life" by decisions of the Tax Court extending over a long period, the useful life of a depreciable asset is its physical or economic life as opposed to measuring such life by the period during which such asset happened to be used in business by a particular taxpayer. We likewise rely on that portion of the excellent and very comprehensive opinion of the District Court dealing with this matter under the 1939 Code in *Hertz v. United States*, 165 F.Supp. 261, which case is now before the Court on the same question presented by Petitioner's case.

II.

The Government should not have been permitted to raise the issue of the definition of "useful life" and "salvage value" for the first time while this case was on appeal before the Fifth Circuit. From an examination of the pleadings in this case, including Petitioner's claim for refund, and the Commissioner's agent's report, it will be readily apparent that the case arose on the question of whether or not the company and rental cars in question were held primarily for sale or primarily for use in trade or business. After the District Court held that the cars were held primarily for use in trade or business and hence subject to long-term capital gains treatment under Section 117(j), following in substance the prior cases of *Latimer-Looney Chevrolet Company, Inc. v. Commissioner*, 19 T.C. 120 (1952); *Arthur L. Fields v. Granquist*, 134 F.Supp. 624 (D.C. Ore. 1955); *W. R. Stephens Co. v. Kelm*, 140 F.Supp. 12 (D.C. Minn. 1956); *Philber Equipment Corp. v. Commissioner*, 237 F.2d 129 (3rd Cir. 1956), the Government then injected its theory on appeal that even

though the company cars were held primarily for use in trade or business, they were not subject to an allowance for depreciation, since their useful life was one year, and the salvage value was substantially equivalent to the price received on their sale.

The Commissioner, in auditing Petitioner's returns for the two fiscal years involved in this case disallowed all of the depreciation shown on the returns with respect to the company cars in issue on the theory that the assets were inventoried property and not therefore as a matter of law subject to any allowance for depreciation.

As the case stood before the District Court, if the Court held from the facts that the cars were held primarily for use in trade or business for more than six months, then capital gains treatment would be allowed under Section 117(j), and the depreciation shown with respect thereto on Petitioner's original returns would be allowed. If, on the other hand, the Court had found that the cars were held primarily for sale or constituted inventory property, then there would be no capital gains allowable, and likewise no depreciation could be taken.

III.

Depreciation deductions for Federal income tax purposes are not subject to change due to fluctuation in the value of fixed assets. One of the major factors which apparently prompted or influenced the majority of the Fifth Circuit in this case to reverse the District Court's holding was the fact that in the aggregate Petitioner realized slightly more on the sale of all of the company cars in issue than they originally cost without regard to the depreciation claimed. This is an

undisputed fact, but Petitioner contends that mere fluctuation in market value, either upward or downward should not cause the loss of a depreciation deduction under Section 23(1) of the 1939 Code. Further, in this connection, the tax years involved in this suit are 1950 and 1951, and one of the principal reasons why the company and rental cars were resold at such an advantage was because of the Korean War and the unusual demand and short supply of cars.

IV.

The decision of the Fifth Circuit in this case will lead to unnecessary confusion and uncertainty in income tax matters involving questions of depreciation. The Fifth Circuit's holding that the term "useful life" means the useful life of a fixed asset in the hands of a particular taxpayer, will obviously add to the mounting confusion and uncertainty in Federal income tax matters. Obviously, there will be no objective guide which taxpayers can follow in establishing the useful life of depreciable assets and a proper rate or percentage of depreciation to be taken in filing their returns. The useful life, and hence the rate to be applied will, under the theory of the Fifth Circuit, be determined by the particular trade practices which happen to prevail from time to time, in a taxpayer's trade or business. This, we submit, violates the traditional and long-standing concept and understanding of depreciation, and should be reversed.

ARGUMENT

I.

FOR PURPOSES OF COMPUTING DEPRECIATION WITH RESPECT TO PROPERTY USED IN TRADE OR BUSINESS UNDER SECTION 23(1) OF THE INTERNAL REVENUE CODE OF 1939 ON THE STRAIGHT-LINE METHOD, THE USEFUL LIFE TO BE USED IS THE PHYSICAL OR ECONOMIC LIFE OF SUCH ASSET AND ITS SALVAGE VALUE, IF ANY, IS TO BE DETERMINED AS OF THE END OF SUCH PHYSICAL OR ECONOMIC USEFUL LIFE.

First, we think it appropriate to review the history and circumstances under which the instant case arose. Massey Motors, Inc., and its wholly-owned subsidiary, Atlantic Motor Sales, Inc., used a number of automobiles from its new car inventory in the operation of its business as company and leased vehicles and, in so doing, the cars became property bona fide used in the operation of the company's new car sales agency.

The company, in filing its corporate Federal income tax return for the calendar years 1950 and 1951, claimed depreciation with respect to the vehicles in question, utilizing an estimated useful life of three years, claiming a deduction with respect to all company cars for 1950 in the amount of \$12,105.22 and \$14,860.42 for 1951. During both of the calendar years in question, a number of the company cars were sold and, with respect to those held in service for more than six months, capital gains treatment was claimed under the provisions of Section 117(j) of the Internal Revenue Code of 1939.

The Commissioner, in causing the returns to be audited,

disallowed capital gains treatment on the theory that the company cars were stock in trade, rather than property used in trade or business, and were not, therefore, subject to any allowance whatever for depreciation and any gains realized with respect to the sale thereof constituted ordinary income and not capital gain. The position of the Commissioner is readily apparent from an examination of pages 2, 3, 4, 6 and 7 of Plaintiff's Exhibit 5 (R. 151-156). Massey Motors paid the deficiency as determined by the Commissioner on the basis of the 30-day letter, filed a claim for refund thereof, and in due course instituted a suit for refund in the United States District Court for the Southern District of Florida, Jacksonville Division.

Inasmuch as the Commissioner had assessed the deficiency on the theory that the company cars were inventory property and hence held primarily for sale, the case was tried in the District Court on this issue, namely, whether the company cars were used primarily for the operation of Petitioner's business, and incidentally for sale, or whether they were held primarily for sale and incidentally for use in the business. If the cars were held primarily for use in the business for more than six months, then under the express provisions of Section 117(j) any gain realized from the sale thereof would be long-term capital gain and any loss would constitute an ordinary loss. The Commissioner's agent followed a consistent pattern in disallowing the depreciation claimed with respect to the cars in issue in toto, since under his theory the cars were inventory property and hence non-depreciable as a matter of law. In other words, the Commissioner in the first instance did not raise any issue as to definitions of the terms "useful life" and "salvage value" in connection with the depreciation issue, but simply disallowed these items in full on the legal premise that the cars were inventory property.

There was little or no testimony or other evidence introduced before the District Court when the case was tried relating to the question of depreciation. It was Petitioner's theory that if the District Court held that the cars were used primarily in business and were not held primarily for sale, then, as an automatic proposition of law, the depreciation claimed would be allowed and, likewise, the long-term gains claimed with respect to gains realized on the sale of some of these cars held for more than six months would be allowable.

The Government, in prosecuting its appeal, abandoned the issue as to whether or not the cars in issue were held primarily for sale or for use in the taxpayer's business, and to this extent accepted the findings of the District Court. Instead, the Government based its case on the theory that Petitioner was not entitled to any depreciation with respect to the vehicles on the grounds that inasmuch as the cars were admittedly kept in service for approximately one year, their useful life for purposes of computing any allowable depreciation was one year and not three years and that the salvage value properly assignable thereto was the amount received on the ultimate sale of the units. The Court of Appeals sustained the Government on this point with the minor exception that the case was remanded to the District Court with instructions to hear such evidence as might be appropriate to determine whether the salvage value should be the retail price received for the used units or their wholesale value, since Petitioner acquired the cars in the first instance on the wholesale market. Also, there was another minor issue in the case before the Courts below involving a question of Petitioner's taxability with respect to certain finance reserve holdbacks, which has now become academic by virtue of the

recent decision of this Court in *Commissioner v. Hansen*, 360 U.S. 446 (1959).

Although the instant case involves a relatively small sum, we think that the case is one of great importance to taxpayers in general, and involves the identical question presented in *Commissioner v. Evans*, No. 143, and *The Hertz Corporation v. United States*, No. 283, with respect to which all three cases certiorari was granted on October 12, 1959.

Although the three cases involve the identical question of law, the case of *Commissioner v. Evans* is more nearly akin to the problem presented than the case of *The Hertz Corporation v. United States*. Both the instant case and the *Evans* case involve an interpretation of Section 23(1) under the 1939 Code, and Treasury Regulations 111, Section 29.23-1, and both involve the identical tax years; whereas, the *Hertz* case arose under the 1954 Code, and for this reason, the Court may ultimately reach a different conclusion with respect to the issue presented; depending upon whether a case arose under the 1939 Code or the 1954 Code. As the Court is aware, both the *Evans* and *Hertz* cases involve only rental automobiles; whereas, the Petitioner's case involves both rental automobiles and company cars used in the operation of a retail automobile dealership, although the slight difference in underlying facts is wholly immaterial in so far as the ultimate legal conclusion is concerned. We think the Government will agree with this conclusion.

At the time that Petitioner's case was under consideration by the Fifth Circuit, the Ninth Circuit, in a unanimous decision in *Evans v. Commissioner*, 264 F.2d 502, decided January 26, 1959, reversed the decision of the Tax Court on the point here involved, and in effect held that under Sec-

tion 23(1) of the 1939 Code, the term "useful life" means the physical or economic life inherent in a depreciable asset for general business purposes by whomever used and that salvage value is the value at the end of such period, and refused to accept the Commissioner's theory that useful life for this purpose should be defined as the useful life measured by the particular taxpayer's use of the asset and that salvage value means the estimated proceeds which might be realized upon the disposition of the property. The Ninth Circuit in the *Evans* case also cited the decision of the District Court in Petitioner's case with approval.

Needless to say, Petitioner bases its case on the theory and rationale of the Ninth Circuit's opinion in the *Evans* case, and urges the Court to adopt such theory as controlling with respect to the issue involved in this case. We, therefore, do not think it necessary to attempt to paraphrase or condense the theory of the Ninth Circuit on brief.

We likewise believe that the District Court, in *Hertz v. United States*, 165 F.Supp. 261, correctly set forth the proper view of the law involving this issue as it relates to cases arising under Section 23(1) of the 1939 Code.

Inasmuch as Petitioner's case does not involve any taxable year arising under the 1954 Code or the Treasury Regulations issued thereunder, we do not think it proper that we attempt to address any of our remarks to the present state of the law.

We believe, however, that the Sixth Circuit erred in *Hertz Corporation v. United States*, 268 F.2d 604, in reversing the District Court by holding, in effect, that the term "useful life" for purposes of computing allowances for depreciation

for Federal income tax purposes has always meant the useful life of the assets in the hands of a particular taxpayer, both under the 1939 Code and the 1954 Code. We believe that whatever the state of the law under the 1954 Code, the term "useful life" under the 1939 Code meant the inherent physical or economic life of a depreciable asset. Therefore, we submit that the Ninth Circuit, in *Evans v. Commissioner*, correctly held that under Section 23(1) of the 1939 Code, the language of the applicable Treasury Regulations, Section 29.23(1), the consistent practice and position of the Commissioner over many years and the interpretation placed on the term "useful life" by decisions of the Tax Court extending over a long period, the useful life of a depreciable asset for Federal income tax purposes under the 1939 Code is its physical or economic life as opposed to measuring such life by the period during which such asset may be held for use in business by a particular taxpayer.

II.

THE GOVERNMENT SHOULD NOT HAVE BEEN PERMITTED TO RAISE THE ISSUE OF THE DEFINITION OF "THE USEFUL LIFE" AND "SALVAGE VALUE" FOR THE FIRST TIME ON APPEAL.

An examination of the Complaint, Claims for Refund filed herein (R. 1-12), the Government's Answer (R. 13-15), the Agent's Report (R. 151-156) will show that there was no issue raised by the Government with respect to the definition of "useful life" or "salvage value" in connection with the cars in issue. Plaintiff's case before the Trial Court was presented on the theory that the Government took the position that all the cars were held primarily for sale and hence not entitled to capital gains treatment under Section 117(j) of

the 1939 Code and that no depreciation in any amount was allowable. Since this was the Government's express theory from the time the Examining Agent questioned Petitioner's return, the Government first squarely raised the issue presented in this case in filing its brief before the Court of Appeals for the Fifth Circuit.

This factor led Petitioner to take the position before the Court of Appeals that the Government had no right to raise the issue involved in this case for the first time on appeal and that inasmuch as the Government had acquiesced in the trial court's holding that the cars were bona fide used in the operation of Petitioner's trade or business, the decision of the trial court should be affirmed and the case disposed of in the same manner as the other substantially identical cases, including the leading Tax Court case of *Latimer-Looney Chevrolet, Inc., v. Commissioner*, 19 T.C. 120 (1952).

The Fifth Circuit held, in effect, that insofar as the claims for refund mentioned the fact that the depreciation had been disallowed, this was sufficient to permit the Government to raise the issue involved. This we think was an inequitable and erroneous conclusion, and should be reversed.

Counsel for Petitioner also tried an identical company car case in *Duval Motor Company v. Commissioner*, 28 T.C. 42, (1957), in which the Commissioner had denied capital gains treatment and depreciation with respect to a Ford dealer's company cars, which action the Tax Court sustained. Duval Motor Company appealed from the adverse decision of the Tax Court to the Court of Appeals for the Fifth Circuit, which affirmed the decision of the Tax Court in *Duval Motor Company v. Commissioner*, 264 F.2d 548. Both the *Duval* and *Massey* cases were argued before the Court at the same time.

In the *Duval Motors* case, the Commissioner had disallowed depreciation in its entirety on the theory that the company cars constituted inventory property held primarily for sale. If the Tax Court had found that the *Duval Motors* company cars were held primarily for use in the taxpayer's business, then the taxpayer would have been entitled to capital gains treatment on the gains realized from the sale of the cars and the depreciation claimed on its original returns would have been allowed. *Duval Motors* claimed depreciation on its company cars on a straight-line method, using an estimated useful life of four years, without any salvage value. The company's practices with respect to disposing of company cars after they had been operated for a specified number of miles or Ford introduced a new model was precisely the same as the trade practices followed by Massey Motors, Inc. There was no issue raised in the *Duval Motors* case with respect to the definition of useful life and salvage value, as in the instant case. In fact, the Commissioner conceded before the Tax Court that *Duval Motors* was entitled to depreciation and capital gains on a number of its company cars and service vehicles.

This then placed us in the somewhat peculiar position of having two identical tax cases, one tried in the Tax Court and one in the District Court involving the identical issue and substantially identical facts, with one trial court holding that the company cars were held primarily for sale and the other trial court holding that the company cars were held primarily for use in the taxpayer's business. The Government acquiesced in the District Court's decision that the cars in the instant case were held primarily for use in trade or business, but, at the same time, raised an issue with respect to the definition of the term "useful life" when the case was on appeal, with the result that both cases were lost.

The Commissioner apparently discovered that he was attacking capital gains treatment under Section 117(j) of the 1939 Code with respect to automobile dealers' company and rental cars on the wrong theory and it was not, in so far as we know, until the appeal in the instant case and the decision of the Ninth Circuit in *Evans v. Commissioner* and the decision of the District Court in *Hertz v. United States* that the Commissioner for the first time sought to invoke his radical and unorthodox theory that useful life for purposes of computing depreciation deductions for Federal income tax purposes means the useful life of a depreciable asset in the hands of a particular taxpayer, rather than the inherent physical life of such an asset. We think, therefore, that it can be fairly stated that the Government's position in the instant case is in the nature of an afterthought, and should not be sustained, at least with respect to cases arising under the 1939 Code.

One of the chief difficulties with the decision of the Fifth Circuit is that in order to reach the result that the majority of the Court did with respect to the definition of useful life, it was necessary to in effect, invalidate, in part the Treasury Regulations in force during the calendar years 1950 and 1951 issued pursuant to Section 23(1) of the 1939 Code.

Treasury Regulations 111, Section 29.23(1), provide "the proper allowance for such depreciation is that amount which should be set aside for the taxable year, in accordance with their reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will at the end of the *useful life of the depreciable property*, equal the cost or other basis of the property--."

The same Regulations, at Section 29.23(5), dealing with

the method of computing depreciation allowance, states:

"The capital sum to be recovered shall be charged off over *the useful life of the property*, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production."

The Ninth Circuit, in the *Evans* case and the District Court in the *Hertz* case, found that these Regulations made it clear that the Treasury was defining useful life as meaning the inherent physical or economic life of an asset in the hands of taxpayers in general.

As we understand the law, a Treasury Regulation, such as the one issued under Section 23(1) of the 1939 Code, has the force and effect of the statutory law itself.

We, therefore, submit that the Commissioner, whether advertently or inadvertently, by amending his regulations under Section 23(1) in 1942, placed himself in a position whereby the term "useful life" for the purposes in question meant physical or economic life of a depreciable asset.

The Court of Appeals, in discussing the 1942 amendment to the regulations states (R. 139): "A cursory look at the legislative history back of this amendment clearly demonstrates that there was no purpose to express a change in what was meant by useful life." And the Court goes on to explain why the regulations were amended.

We, frankly, do not know what the Court meant by the legislative history of the 1942 amended regulations. In so far as Counsel knows, there is no such thing as legislative history of a Treasury Regulation, and that the regulations must

be construed as they appear in final form. There is no published legislative history of Treasury Regulations akin to Committee Reports published while Congress is considering amendments to the Internal Revenue Code or other Federal Statutes, as an aid in statutory construction.

The majority of the Court of Appeals, in commenting (R. 139) on the Treasury Regulations issued pursuant to 1954 Code, stated: "Thereafter, when the 1954 Internal Revenue Code was adopted, without any change in the depreciation section of the law, the Treasury promulgated the regulations under it." The Court went on to quote the sections of the present regulations issued under Section 167 of the 1954 Code, defining for the first time salvage value and also defining useful life as the life in a particular taxpayer's trade or business.

In this connection, we would like to point out that it is not accurate to say that the 1954 Code was adopted without any change in the depreciation section of the law.

We would like to suggest to the Court that even a cursory comparison of Section 23(1) of the 1939 Code with Section 167 of the 1954 Code will show that there are a great many differences with respect to the depreciation sections. For example, the 1954 Code for the first time expressly authorized the use of the sum of the digits and declining balance method of computing depreciation, and the accelerated methods obviously prompted Congress to give consideration to matters of salvage value and useful life. Section 167 of the 1954 Code for the first time mentioned the term "useful life", although the term is without definition, and it is the lack of any such definition, either in the 1939 Code or 1954 Code which causes the difficulty involved in the present litigation.

The Court of Appeals also cites the decision of this Court in *United States v. Ludey*, 274 U.S. 295, as determinative of the question of definition of useful life.

The *Ludey* case was decided by the Court in 1927 and an examination of the opinion of Mr. Justice Brandeis will show that the case did not involve a question of the definition of the terms "useful life" or "salvage value". In fact, we think that the *Ludey* case clearly supports the instant petitioner's contentions. The case involved a question of whether or not in determining gain or loss upon the sale of oil mining equipment and oil reserves in 1917, the cost thereof should be reduced by the aggregate amounts of depreciation and depletion, which the taxpayer was entitled to deduct in years prior to sale, though not deducted on the returns for prior years. It appeared that the taxpayer in this case had certain oil mining properties originally costing \$95,977.33 and which were sold in 1917 at a price of \$81,200.00. The Commissioner, in computing the gains realized on the sale by the taxpayer, deducted from the original cost of the assets \$10,465.16 on account of depreciation of the equipment and \$32,258.81 on account of depletion reserves through the taking out of oil by the taxpayer after March 1, 1913.

The taxpayer insisted that with respect to depreciation the property was, as a matter of law, unchanged in character and quantity throughout the period of operation and that his basis for gain or loss should not be reduced so as to increase his gain.

The Court held that the Revenue Acts should be construed as requiring deductions for both depreciation and depletion when determining the original cost of the oil property sold. The Court was holding that depreciation is allowed

or allowable and that the basis of a depreciable asset would have to be adjusted downward whether or not the taxpayer had in fact claimed depreciation deductions in prior years or had received any tax benefit with respect thereto.

The opinion does go on to explain the general concept of depreciation and, among other remarks, states "the depreciation charge permitted as a deduction from the gross income in determining the taxable income of a business for any year, represents a reduction during the year of the capital assets through wear and tear of the plant used. The amount of allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sum set aside will (with the salvage value) suffice to provide an amount equal to the original cost."

It is apparently this incidental general language which the Court of Appeals in the present case considered as determinative of the question involving the definition of useful life. It is difficult for us to follow this reasoning, in view of the fact that the *Ludey* case did not involve any question of the definitions of "useful life" or "salvage value" and, in fact, it was expressly stated that there was no dispute between the parties as to the method of computation employed by the Bureau of Internal Revenue.

We believe that the present case, together with the related *Evans* and *Hertz* cases, are the first cases to come before this Court requiring specifically the definition of "useful life" and "salvage value" for the purposes in question.

The Fifth Circuit in its opinion (R. 140) cites the Treasury's Bulletin E as supporting its theory that the Commissioner

has always taken the position that useful life means the life of a depreciable asset in the hands of a particular taxpayer. The Ninth Circuit in the *Evans* case reaches a diametrically opposed conclusion, and several pages of the opinion are devoted to an excellent discussion of this point.

Bulletin F, as the Court may know, was published by the Treasury Department in 1931 and revised in 1942, as an objective aid to taxpayers in computing depreciation for Federal income tax purposes by establishing a published guide as to what the Commissioner would consider as a reasonable estimated useful life for purposes of computing depreciation.

This Bulletin is conveniently reproduced in all major Tax Services, including the Commerce Clearing House Standard Federal Tax Reporter for the year 1960 in Volume 2, at paragraphs 1776 to 1777.395.

In connection with automobiles, Bulletin F states at page 52 that the recommended estimated useful life for passenger cars is five years, and for salesman cars, three years, when used by commercial enterprises other than public utilities and construction. The petitioner in the instant case elected to use three years as the useful life and one of the permissive lives set forth in Bulletin F.

We urge the Court, if possible, to examine Bulletin F in general, and we think that any objective examination of this publication will compel the conclusion that the Commissioner defined useful life for the purposes in question as the general inherent economic or physical life of depreciable assets as compared with the useful life of such an asset in the hands of a particular business or individual.

III.

DEPRECIATION DEDUCTIONS FOR FEDERAL INCOME TAX PURPOSES ARE NOT SUBJECT TO CHANGE DUE TO FLUCTUATIONS IN THE VALUE OF FIXED ASSETS.

We recognize that one of the chief difficulties with petitioner's case on its own facts is that the cars in question in the aggregate were sold for more than their original cost without regard to depreciation. However, we construe the *Ludey* case as requiring petitioner to take depreciation on these cars which were on hand at the end of any particular taxable year, once it was concluded that the cars were property held primarily for use in trade or business, without regard to fluctuations in market value.

As we understand it, depreciation is primarily an accounting concept. As an accounting concept, depreciation is allowed or allowable for Federal income tax purposes without regard to fluctuations in price level. We know of no authority which would deny a taxpayer the right to depreciate property used in trade or business or in the production of income, notwithstanding the fact that the property may have appreciated in value in excess of original cost.

For example, the Court well knows that a taxpayer may have purchased a large office building in 1933, at a very low cost, upon which depreciation would be allowed based on an estimated useful life of thirty or perhaps as long as forty years, and that the taxpayer, in filing his return for 1960, will be entitled to this depreciation, notwithstanding the fact that the building may be worth five times its original 1933 acquisition cost. Also, if the taxpayer in 1960 should in fact sell the real estate for many times its original cost, the gain real-

ized would be taxable as a long-term capital gain, under the provisions of Section 1231 of the 1954 Code and its predecessor, Section 117(j) of the 1939 Code.

We believe that the Court of Appeals in the instant case was unduly influenced in its decision by the undisputed fact that during the calendar years 1950 and 1951, petitioner was selling some of the company and leased cars at prices in excess of the original cost after approximately one year of company or lease service. The case is perhaps a classic example of the old maxim that a hard case makes bad law.

We think it is fair comment to point out that one of the reasons why petitioner was able to sell the cars as it did in 1950 and 1951 was the result of extremely favorable market conditions, growing out of the Korean War, and we re-say that very few, if any, automobile dealers today can sell a company car after one year of service for anything even approaching its original cost.

There have been a number of Tax Court cases which have held that a depreciation deduction cannot be disallowed merely by reason of the price received for the article, without consideration of other factors. We know of no other direct authority on this point, except as cited herein. Perhaps, the most important of these cases is *Wier Long Leaf Lumber Co. v. Commissioner*, 9 T.C. 990 (1947), which was reviewed by the Fifth Circuit and modified on other grounds at 173 F.2d 549. The findings of fact of the Tax Court show that in 1942 the petitioner sold three automobiles which had cost \$2,854.85 and had a depreciation reserve of \$1,148.39 accumulated to January 1, 1942, and that petitioner, in its tax return for 1942, deducted \$1,047.53 as a reasonable allowance for depreciation on the cars.

The Commissioner, in auditing the return, allowed as a deduction the sum of \$592.94 on the theory that the depreciation was reduced, so that the net book value would be equal to the sales price and no gain or loss would result. The depreciation taken by petitioner was 40 per cent per annum. The Tax Court in effect held that the Commissioner could not readjust the depreciation allowance merely because of price received on the sale of the article. It should be noted that the car was sold in 1942 after commencement of World War II and obviously the increased price for used cars during this time was a factor which permitted the company to make a favorable sale of the three used cars. Petitioner's situation was likewise influenced by the Korean War.

There are a number of other cases which hold that the mere appreciation in value due to extraneous causes has no influence on depreciation allowances one way or the other. *Even Realty Co.*, 1 B.T.A. 355, *Seaton Falls Realty Co.*, 6 B.T.A. 883, *Max Eichenberg*, 16 B.T.A. 1368, and *Thomas Goggan & Bro.*, 45 B.T.A. 218.

It was also held in *Louis Titus*, 2 B.T.A. 754, that "in determining the annual depreciation to be allowed, consideration cannot be given to the fluctuations in cost or value of the asset which may take place from year to year owing to market conditions." We take this to mean that a taxpayer is not entitled to accelerate its customary rate of depreciation merely because the market value of a depreciable asset goes down in a particular year, nor should a taxpayer be denied the right to his customary rate, simply because the market value for a particular depreciable asset or group of assets has tended to remain constant for a particular year or risen slightly in value as compared to the taxpayer's cost. The Court can readily see the complete hiatus that the matter

of depreciation will be in if taxpayers are permitted or required to adjust their rates of depreciation to reflect upward or downward trends in price level. It is elementary that income taxes are computed on the basis of an annual accounting period, and once the method of depreciation is selected and the rate established, assuming it to be reasonable, it must be adhered to, notwithstanding fluctuations in price level, either upward or downward.

One of the most unfortunate features of our present Federal income tax structure is the great amount of uncertainty which has been prompted to some measure by the way in which many of the provisions of the present Code have been enacted by Congress and also by the over-zealous manner in which the laws have been administered by the Internal Revenue Service, both at the administrative level and before the Courts. The present case is an excellent example of this unfortunate condition. If the Court supports and ratifies the Government's claim that "useful life" means the life of a depreciable asset as used in a particular taxpayer's business, then there will be no certainty whatever available as a guide to taxpayers in general in selecting an estimated useful life for purposes of computing their annual allowance for depreciation. In this connection, Bulletin F may as well be scrapped in its entirety.

IV.

THE DECISION OF THE FIFTH CIRCUIT IN THIS CASE WILL INJECT UNNECESSARY CONFUSION AND UNCERTAINTY IN THE INCOME TAX MATTER RELATIVE TO DEDUCTIONS FOR DEPRECIATION.

As the Court can readily appreciate, the issue involved in

this case and the *Evans* and *Hertz* cases is of considerable importance to taxpayers in general, and is in no manner limited or confined to automobile dealer and rental car companies.

If the Court should agree with the Government's theory, then many taxpayers will be able to gain excessive depreciation deductions as a result of establishing a history or pattern of using depreciable fixed assets for periods considerably less than their true economic or physical life. For example, a company engaged in manufacturing might purchase certain heavy machinery that normally would carry an estimated useful life of ten years, and commence disposing of such equipment at the end of five or perhaps six years. By varying the business practice, the useful life of such equipment would become five or six years instead of ten years. The statute of limitations would in most cases prevent the Government from readjusting such depreciation in years not open for examination, and gains realized on the sale or other disposition of such property would be taxable as long-term capital gain under Section 1231 of the 1954 Code.

If the Government's theory that useful life means the life of an asset in a particular taxpayer's business as opposed to its inherent physical life, then the Government might reduce the adjusted basis of such asset for purposes of computing gain or loss on its sale under the theory that the taxpayer had not depreciated the item rapidly enough because it had used an estimated useful life of fifteen years when business practices showed that it should have been ten years.

The Government's theory should it prevail will increase to a considerable measure the confusion and bickering in connection with Federal income tax matters for years to come, both from the standpoint of a taxpayer seeking a tax advantage and the Government seeking to extract additional taxes.

In further support of our contention that the Government's position in this case is an afterthought, we would like to call the Court's attention to the decision of the Court of Appeals for the First Circuit in *Philber Equipment Corp. v. Commissioner*, 237 F.2d 129, decided September 27, 1956, reversing a decision of the Tax Court, 25 T.C. 88 (1955).

The Philber Equipment Corporation, a Pennsylvania corporation, was in the business of owning and leasing trucks and other vehicles and followed the practice of disposing of such units after approximately one year of service in more or less the same manner as the petitioner and the taxpayers in the *Evans* and *Hertz* cases.

The Commissioner in attacking the capital gains claimed on profits realized from the sale of these used rental vehicles proceeded on the theory that no capital gains were allowed under Section 117(j) on the theory that the vehicles at the time of disposition were held primarily for sale and hence did not qualify under this Section.

It is interesting to note that the Tax Court's opinion written by Judge Raum made a specific finding of fact that each of the units involved were held by the petitioner for a period in excess of six months and was subject to an allowance for depreciation.

The Tax Court upheld the Commissioner's determination and was reversed by the Third Circuit, so that the taxpayer ultimately prevailed on the capital gain issue for the years involved, which were incidentally the two fiscal years ended June 30, 1951 and 1952.

Thus, we see that the Commissioner was not then contending that Philber Equipment Corporation was not entitled to

depreciation on the units on the theory that the "useful life" of the property was one year and "salvage value" was equal to the amount realized on the sale of the units. The Court will appreciate that in cases of this kind, the tax consequences insofar as the taxpayer is concerned will be identical whether capital gains treatment under Section 117(j) is denied or depreciation is disallowed on the theory that the "useful life" of the units is one year, and the "salvage value" is equal to the amount received on this sale.

We think it fair comment to point out that the Government has never been sympathetic to Section 117(j), which was enacted as a remedial statute by Congress as a part of the Revenue Act of 1942.

Apparently, the reason for the enactment of the statute was that prior to its effective date, gains realized on the sale of depreciable property used in trade or business constituted ordinary income regardless of the holding period. Many taxpayers were reluctant to sell depreciable property which had been acquired during the depression years and which had increased in value because of the World War II, when they were faced with ordinary income as opposed to capital gain.

Apparently, Congress in an effort to correct this situation and prompt taxpayers to dispose of fixed assets which they were not using during the war period enacted Section 117(j) to give capital gains treatment on gains realized from the sale of this type of asset, and at the same time, provided that if a Section 117(j) asset is sold at a loss, the taxpayer has an ordinary loss and not a capital loss.

This statute then always operates in the taxpayer's favor. If he has a gain, it is a long-term capital gain. On the other hand, if he has a loss, the loss is an ordinary loss.

If the Government ultimately prevails in this case, it will be in a position to abrogate for all practical purposes the normal operation of Section 117(j) of the 1939 Code and its counterpart Section 1231 of the 1954 Code. This would follow, because the Government will be in a position to attack any capital gain realized under Section 117(j) by, in effect, adjusting the taxpayer's prior deductions for depreciation on the grounds that the "useful life" of the asset was the time during which the asset was held by the taxpayer, and that its "salvage value" should be substantially equal to the amount realized on the sale.

This would be particularly true of depreciable assets which are readily salable such as automobiles.

If the Commissioner feels that over the long range, the tax results which would follow if the District Court's decision were sustained are undesirable, then he ought to approach Congress for a statutory amendment to those sections of the Code dealing with depreciation and capital gains or losses on the sale of such assets, rather than seeking a judicial determination to this effect, and which if adopted; will reverse long-standing business practices on a completely inequitable and retroactive basis. Also, as we have stated above, the Commissioner's theory will necessarily inject a great deal of uncertainty and confusion in those areas of Federal income tax law and practice involving depreciation. It would seem unwise for the Government to attempt to inject this element of uncertainty because of several isolated cases which give rather unusual tax results due primarily to price level increases caused by the Korean War.

CONCLUSION

Based upon the foregoing, it is respectively submitted that the decision of the majority of the Court of Appeals for the Fifth Circuit is in error, and the Court should adopt the theory of the Ninth Circuit in *Evans v. Commissioner* that the definition of useful life for purposes of computing allowances for depreciation for Federal income tax purposes under the Internal Revenue Code of 1939 for the calendar years 1950 and 1951 means the inherent physical or economic life of such asset and that salvage value is to be determined at the end of such life. We, therefore, urge the Court to reverse the majority decision of the Fifth Circuit and remand the case to the District Court for a proper determination of the salvage value to be assigned to the vehicles in question at the end of their physical or economic life.

Respectfully submitted,

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CERTIFICATE OF SERVICE

It is hereby certified that four (4) copies of the foregoing Brief have been served on opposing counsel, The Honorable J. Lee Rankin, Solicitor General of the United States, by mail at his last known mailing address, Department of Justice, Washington-25, D. C., on this 22nd day of January, A. D. 1960, in accordance with Rule 33 of the Rules of the Supreme Court of the United States.

DATED this 22nd day of January, A. D. 1960.

JAMES P. HILL
Counsel for Petitioner

APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME

In computing net income there shall be allowed as deductions:

(1) [as amended by Sec. 121(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(26 U.S.C. 1952 ed., Sec. 23.)

Internal Revenue Code of 1939:

SEC. 117. CAPITAL GAINS AND LOSSES

(j) *Gains and Losses from Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business*.—

(1) *Definition of Property Used in the Trade or Business*.—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the

taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) General Rule.--If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business, or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.23(1)-1. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. Due regard must also be given to expenditures for current upkeep. • • •

SEC. 29.23(1)-2. *Depreciable Property.*—The necessity for a depreciation allowance arises from the fact that certain property used in the business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the busi-

ness. It does not apply to inventories or to stock in trade, or to land apart from the improvements or physical development added to it. It does not apply to bodies or minerals which through the process of removal suffer depletion, other provisions for this being made in the Internal Revenue Code. (See sections 23(m) and 114). Property kept in repair may, nevertheless, be the subject of a depreciation allowance: (See section 29.23(a)-4). The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business, or treated under section 20.23(a)-15 as held by the taxpayer for the production of income. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, or in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

.

SEC. 29.23(1)-4. Capital Sum Recoverable Through Depreciation Allowances.—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113(a) and 114.) To this amount should be added from time to time the cost of improvements, additions, and betterments, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. (See section 113(b).) . . .

SEC. 29.23(1)-5 Method of Computing Depreciation Allowance.—The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. ~~What-~~ ever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed.

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. • • •

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James E. McGuire, Clerk

In the Supreme Court of the United States

October Term, 1949

MARSH MOTORS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

**ON WRIT OF HABEAS CORPUS TO THE UNITED STATES COURT OF
APPEALS FOR THE FIFTH CIRCUIT**

PRISON FOR THE UNITED STATES

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Solicitor General,

CHARLES E. HUGH,

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In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 141

MASSEY MOTORS, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 105-117, 121-124) are reported at 156 F. Supp. 516. The opinion of the Court of Appeals (R. 132-144) is reported at 264 F. 2d 552.

JURISDICTION

The judgment of the Court of Appeals was entered on February 26, 1959. (R. 144.) On May 22, 1959, by order of Mr. Justice Black, the time within which to petition for a writ of certiorari was extended to and including July 13, 1959. (R. 145.) The petition was filed on June 24, 1959, and the writ was granted on October 12, 1959, 361 U.S. 810. (R. 145.)

The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1).

QUESTION PRESENTED

Taxpayer, an automobile dealer, withdrew from inventory certain automobiles which it bought during the calendar years 1950 and 1951. It assigned approximately one-half of these to employees for transportation in connection with the company's business. The other half it rented to an unaffiliated finance company. Taxpayer's practice was to dispose of both leased and "company" cars at the time of a model change or earlier—in all events, long before the end of their physical or economic life. All of the cars in question were sold (as used cars) for very substantial prices (in most instances, at figures in excess of taxpayer's purchase price).

The question, relating to the "reasonable" allowance for depreciation authorized by Section 23(1) of the Internal Revenue Code of 1939, is whether the "company" cars and leased automobiles are depreciable (as the Government contends) on the basis of their estimated useful life in the taxpayer's business, using a depreciation base consisting of cost less the substantial resale value of the automobiles at the end of their useful life in taxpayer's business, rather than (as taxpayer contends) on the basis of the longer physical life of the automobiles, with cost less salvage value at the end of their physical life as the depreciation base.

STATUTES AND REGULATIONS INVOLVED

Sections 23(1) and 3791(a) and (b) of the Internal Revenue Code of 1939, and Sections 29.23(1)-1, 29.23(1)-2, 29.23(1)-4 and 29.23(1)-5 of Treasury Regulations 111 are set forth in Appendix A; *infra*, pp. 12-15.

STATEMENT

In 1950 and 1951, taxpayer, a franchised Chrysler dealer, withdrew from shipments of new cars which it received fifty-one and fifty-three automobiles, respectively. Approximately one-half of these were assigned to company executives and other employees for use in connection with the company's business.¹ (R. 110-111, 121-122, 133). The other half were rented to an unaffiliated finance company at a net rental of three cents a mile, which yielded taxpayer a substantial net profit. (R. 122, 133.)

The company cars were uniformly sold at the end of 8,000 to 10,000 miles' use or upon the receipt of new models, whichever was earlier. The rental cars were sold upon 40,000 miles of use or upon receipt of new models. In nearly every instance, the company cars were sold for more than they cost taxpayer; on the average, the rental cars also brought something above original cost. (R. 111-112, 133.) Thus, the company cars in issue were sold for \$11,272.80 more than their aggregate cost, and the rental cars for \$525.84 more than their total cost. (R. 133.) In 1950, taxpayer sold twenty-seven of the fifty-one cars which had been withdrawn from inventory, and in

¹ We refer to these as company cars.

1951 it sold twenty-three of the cars withdrawn from inventory.² (R. 122.)

Taxpayer figured depreciation on all of the cars on the straight line basis, with no allowance for salvage value. Gains on the sales were computed at capital gains' rates with a basis of cost less depreciation. (R. 133.) The Commissioner disallowed capital gains treatment on the ground that the automobiles were not property used in the trade or business under Sec-

² The following tables, which have been adjusted for duplications and items not in issue, show the length of time the company cars and leased cars were held by taxpayer, their cost and sales price, and the depreciation claimed (Exs. 3 and 4, R. 147-150):

Company cars used and sold in 1950 and 1951

Item No.	Date purchased	Date sold	Cost price	Sales price	Total depreciation claimed
4...2	10-12-49	1-17-50	\$1,850.94	\$2,095.00	\$154.41
5.....	10-10-49	1- 2-50	1,738.93	1,995.00	145.03
6.....	11- 1-49	1- 7-50	1,730.46	1,977.00	98.42
7.....	11- 1-49	4-14-50	1,730.47	2,095.00	192.55
9.....	1- 3-50	6-20-50	2,026.82	2,820.30	281.82
10.....	6- 5-50	10- 7-50	1,704.84	2,695.00	186.64
16.....	7-12-50	9- 1-51	1,836.87	2,250.00	51.17
17.....	7-19-50	10-30-51	1,810.36	2,493.10	160.84
18.....	9-11-50	11-14-50	1,966.00	2,695.15	108.78
19.....	5-19-50	7-31-50	1,960.50	2,485.93	110.66
22.....	5-25-49	4-14-50	1,490.85	1,695.00	416.60
26.....	6-29-49	1-10-50	2,090.43	2,695.00	347.93
28.....	10- 6-49	6- 8-50	1,660.61	1,819.70	369.25
30.....	12-21-49	7-27-50	1,864.23	2,490.00	316.93
42, 79.....	6- 7-50	3- 3-51	1,831.75	1,910.00	487.99
46, 58.....	8-17-50	2-28-51	2,180.60	2,595.00	364.20
50, 60.....	8-30-50	2- 6-51	2,107.65	2,500.00	292.91
52, 62.....	10-12-50	2-12-51	1,733.88	2,010.00	144.60
54, 62.....	6-23-50	4-16-51	1,663.69	1,990.00	411.63
56, 63.....	8- 8-50	2-28-51	1,802.75	2,629.85	253.38
64.....	1- 9-51	6-19-51	2,347.86	2,695.00	312.22
65.....	1-24-51	4- 7-51	1,773.53	2,441.62	98.67
66.....	2-14-51	5-30-51	1,891.10	1,917.04	105.08
67.....	4-11-51	5-16-51	1,944.77	2,026.75	0
68.....	3-29-51	8-23-51	2,488.65	2,500.00	279.81
70.....	4-27-51	7- 5-51	1,950.17	1,950.17	54.57
85.....	2-28-51	10-26-51	2,068.13	2,872.28	391.43
Company cars used and sold.....			\$51,175.11	\$92,447.91	\$6,099.35

tion 117(j) of the Internal Revenue Code of 1939, but were held primarily for sale to customers in the ordinary course of taxpayer's trade or business. He also disallowed the depreciation claimed. Taxpayer paid the resulting deficiency and thereafter filed claims for refund, asserting (R. 11) that it was "entitled to a reasonable allowance for depreciation as claimed on the aforementioned automobiles, constituting property used in its trade or business" * * * and that the gain realized by it on the sale of said automobiles is reportable as long term capital gain * * * Upon disallowance of the claims, suit for refund was filed in the District Court. The trial

(Footnote 2—Continued.)

Cars leased in 1950 and 1951

Item No.	Date purchased	Date sold	Cost price	Sales price	Total depreciation claimed
2.....	6-30-49	1-25-50	\$1,958.02	\$2,019.82	\$217.80
8.....	12-21-49	3-27-50	1,860.74	2,495.00	103.62
11.....	6-17-50	7-21-50	1,450.22	2,100.00	40.30
12.....	6-12-50	10-25-50	1,894.00	1,477.50	210.48
13.....	6-15-50	6-29-50	1,475.10	1,475.10	0
14.....	6-7-50	10-3-50	1,475.10	1,500.00	164.06
20.....	4-18-49	7-1-50	1,406.37	1,250.00	586.11
31.....	3-31-49	3-3-50	1,451.18	1,475.00	694.67
32.....	4-20-49	7-14-50	1,363.12	1,505.00	330.20
24.....	5-24-49	6-29-50	1,037.15	1,325.00	645.95
25.....	6-13-49	6-14-50	1,366.55	1,495.00	455.32
27.....	7-19-50	7-25-50	1,800.00	1,400.00	550.00
29.....	11-2-49	7-6-50	1,429.60	1,452.50	317.72
38, 74.....	1-19-50	5-10-51	1,684.41	1,850.00	702.60
39, 75.....	6-2-50	5-25-51	1,476.60	1,300.00	451.35
40, 76.....	6-2-50	7-2-51	1,476.60	1,395.00	333.37
43, 80.....	6-16-50	5-30-51	1,411.02	1,200.00	431.27
44, 81.....	6-16-50	6-20-51	1,411.02	1,350.00	470.46
46, 77.....	6-7-50	9-12-51	1,475.10	1,400.00	614.73
47, 78.....	6-7-50	5-30-51	1,475.10	1,150.00	450.85
51, 61.....	10-16-50	2-23-51	1,978.32	2,005.00	210.92
69.....	4-20-51	7-11-51	1,119.05	1,300.00	93.41
Leased cars used and sold.....			\$34,374.38	\$34,896.92	\$5,363.85
Total of company and leased cars.....			\$85,549.49	\$97,347.83	\$14,433.23

court held in favor of taxpayer, ruling (1) that the cars in question were capital assets, rather than stock in trade, and (2) that the method of taking depreciation, utilizing a thirty-six-months' estimated useful life with no deduction for salvage value, was fair and reasonable. (R. 7-10, 110, 133-134.)

In the court below, the Government abandoned its contention that the property in question was ordinary stock in trade. (R. 132-133.) It pressed contentions that the depreciation must be figured with relation to the known useful life of the assets in the hands of taxpayer, rather than the entire physical life of the property; that the depreciation cannot properly be determined without considering salvage value at the end of the useful life in the hands of taxpayer; that it was demonstrated that useful life in the hands of taxpayer was less than a year; and that the salvage value was no less than original cost. (R. 134.)

The court below (one judge dissenting without opinion) sustained the Commissioner's views as to the meaning of useful life and reversed the judgment. The court also directed that there be a new trial so that the facts relating to salvage value might be more fully developed.³

ARGUMENT

1. The basic legal issue presented by this case—whether taxpayer is to spread depreciation over the estimated useful life of the assets in the taxpayer's

³ The final paragraph of the Court of Appeals' opinion deals with an entirely unrelated issue not before this Court.

business or over a period measured by their expected physical life—is precisely the same issue as is presented in *Commissioner v. Evans*, No. 143. This issue is also involved in *Hertz Corp. v. United States*, No. 283. The arguments which support the Commissioner's view that useful life is to be measured by the taxpayer's holding period are elaborated in our briefs filed in the *Evans* and *Hertz* cases (copies of which are being served upon this petitioner) and, rather than repeating them here, we respectfully refer the Court to the discussion contained in those briefs.

The issue, we point out, arises here in the same context as in *Evans* (although the facts here are somewhat more dramatic). Taxpayer, as noted in the Statement, keeps cars for relatively short periods (see note 2, pp. 4-5, *supra*)—periods so short that it was able to obtain, when it sold the vehicles here involved as used cars, amounts aggregating more than the total purchase price of such cars. Nonetheless, it has assumed that it may take depreciation on the basis of the cars' physical life, which it has estimated at three years.

The practical consequences which follow from this assumption are evident. Salvage value, as taxpayer concedes,⁵ is to be deducted from the base upon which

⁵ In the District Court, taxpayer claimed depreciation without deducting any salvage value, and its position was sustained. (R. 134.) In the Court of Appeals, however, taxpayer conceded that salvage value must be deducted before depreciation is taken. (R. 136.) Its opening caption in the brief filed with this Court (p. 12) states in part that "salvage value, if any, is to be determined as of the end of . . . physical or economic useful life."

straight line depreciation is computed. The salvage value of a late-model automobile is obviously much greater than the salvage value of a comparable automobile several years old. Taxpayer's proposition that salvage value is to be estimated as of the end of physical life and not at the conclusion of taxpayer's holding period would enable taxpayer to ignore what we consider to be actual salvage value—the anticipated price that cars will yield at the time of anticipated sale—and to inflate the depreciation base. Depreciation deductions, of course, are offset against ordinary income, which is taxable at the rate of 52 percent. Although it is true that excessive depreciation is reflected in taxpayer's reported capital gains, capital gains are taxable only at 25 percent.

The facts of this case, as we have said, are dramatic. Taxpayer actually obtains more, when it sells company and rental cars, than its original cost. Thus, in our view, taxpayer is unable to justify deductions for depreciation in any amount: salvage value is not less than cost. Taxpayer's artificial premise—that the useful life of its cars includes their life in other taxpayers' hands—would enable it to take depreciation in circumstances where it has already recovered (or more than recovered) its costs. This, as argued in the *Evans* and *Hertz* briefs, is fundamentally inconsistent with the function that depreciation is designed to serve: "to accrue as to each classification of depreciable property an amount which at the time it is retired will with its salvage value replace the original investment therein," *Detroit Edison Co. v. Commissioner*, 319 U.S. 98, 101.

2. One further aspect of this case requires comment. In its petition for certiorari, taxpayer raised a single question, which it formulated as follows: "Whether petitioner, a retail automobile dealer, is entitled to utilize a 'useful life' of three years in computing depreciation with respect to certain company and rental cars used by it in the operation of its business and an estimated salvage value at the end of such three-year period in filing its Federal corporate income tax return for the calendar years 1950 and 1951." In support of its petition, it asserted a direct conflict with the decision of the Ninth Circuit in the *Evans* case and that the public interest required resolution of this conflict. Agreeing with taxpayer's statement of the question presented, the Government acquiesced in grant of the writ. Taxpayer now insists, in its brief on the merits (p. 17, *et seq.*), that this Court should not decide the question presented by the petition. It suggests that the Government raised that question for the first time on appeal to the Court of Appeals and that it was "erroneous" for that court to consider it.

As we shall point out, the question was before the District Court. If taxpayer is right, however, and the Court of Appeals should not have considered the question which taxpayer has brought here for review, the appropriate disposition would be to dismiss the writ as improvidently granted. Certainly, the question whether the Court of Appeals made a proper appraisal, in a particular case, as to the scope of the issues litigated by the parties in the District Court is not one which has any claim to general importance.

And, in any event, that is not the question which the Court, on taxpayer's petition, decided to review.

Taxpayer's administrative claims for refund put in issue two distinct questions: (1) whether it was entitled to treat gains on the automobiles involved as capital gains (a question which turned on whether the automobiles were held primarily for sale to customers in the ordinary course of business and one which is no longer in the case); (2) whether its deductions for depreciation should have been disallowed. (R. 7-11.) When the claims for refund were denied and taxpayer brought suit, it had the burden on both of these issues. The Government's answer, which denied that taxpayer was entitled to any refund, conceded neither. Nor was there any concession of either issue at any other stage of the trial.⁴ It follows that the Government was fully entitled to contend on appeal that taxpayer had not met its burden of showing that the Commissioner had erred in disallowing the depreciation deductions. The Court of Appeals was correct in its conclusion that the issue of depreciation was "separately raised" in the District Court. (R. 134, n. 3.)

Even if the Court of Appeals' conclusion on this point were questionable (which we do not believe to be the case), the rule that appellate courts will not ordinarily consider legal issues which have not been raised below is one of general policy, not one of jurisdiction, and the policy is not "inflexible." *Hormel v.*

⁴ Moreover, Government counsel, contrary to taxpayer's assertion, argued both points. See Supplemental Record on file with this Court. (not printed) 30-32, 36, 44, 50.

Helvering, 312 U.S. 552, 556. Thus, it was held in the *Hormel* case that, on the Government's appeal, the Court of Appeals had power to consider a taxpayer's liability under a section of the Code which the Commissioner had not relied upon before the Board of Tax Appeals. This Court expressed itself as unwilling, in the circumstances, to permit the taxpayer "wholly to escape payment of a tax which under the record before us he clearly owes." We point out, finally, that the issue before the Court in the instant case was fully briefed and argued before the Court of Appeals, was decided on its merits by that court, and is properly here for review. Cf. *United States v. Bees*, 357 U.S. 51, 54-55.

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted.

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FEBRUARY 1960.

APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed the following deductions:

(1) [as amended by Sec. 121(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(26 U.S.C. 1952 ed., Sec. 23(1)).

SEC. 3791. RULES AND REGULATIONS.

(a) *Authorization*.—

(1) *In general*.—Except as provided in section 1928(a), Cotton Futures, section 2599, Marihuana, section 2559, Narcotics, section 3176, Liquor, and section 1805, Silver, the Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title.

(2) *In case of change in law*.—The Commissioner may make all such regulations, not otherwise provided for, as may have become necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of Regulations or Rulings*.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regu-

lation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U.S.C. 1952 ed., Sec. 3791 (a) and (b)).

* * * * *

Treasury Regulations 111, promulgated October 26, 1943, under the Internal Revenue Code of 1939:

SEC. 29.23(1)-1. *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. Due regard must also be given to expenditures for current upkeep. * * *

SEC. 29.23(1)-2. *Depreciable Property*.—The necessity for a depreciation allowance arises from the fact that certain property used in the business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property

must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, or to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provisions for this being made in the Internal Revenue Code. (See sections 23(m) and 114.) Property kept in repair may, nevertheless, be the subject of a depreciation allowance. (See section 29.23(a)-4.) The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, or in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

SEC. 29.23(1)-4. Capital Sum Recoverable Through Depreciation Allowances.—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113(a) and 114). To this amount should be added from time to time the cost of improvements, additions, and betterments, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. (See section 113(b).) * * *

SEC. 29.23(1)-5. Method of Computing Depreciation Allowance.—The capital sum to be recovered shall be charged off over the useful

life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed.

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. * * *

APPENDIX B

Internal Revenue Code of 1954:

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(b) *Use of Certain Methods and Rates.*—For taxable years ending after December 31, 1953, the term “reasonable allowance” as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

(1) the straight line method,

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had

such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) *Limitations on Use of Certain Methods and Rates.*—Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more.

(f) *Basis for Depreciation.*—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

(26 U.S.C. 1958 ed., Sec. 167 (a), (b), (c) and (f).)

SEC. 7805. RULES AND REGULATIONS.

(a) *Authorization.*—Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of Regulations or Rulings.*—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U.S.C. 1958 ed., Sec. 7805 (a) and (b).)

Treasury Regulations on Income Tax (1954 Code):

SEC. 1.167(a)-1. *Depreciation in general.*—

(a) *Reasonable allowance.* Section 167(a) provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonable consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(f) and § 1.167(f)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. See paragraph (c) below for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value.

(b) *Useful life.* For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factor to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the

taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year and shall be redetermined when necessary regardless of the method of computing depreciation. However, estimated remaining useful life shall be redetermined only when the change in the useful life is significant and there is a clear and convincing basis for the redetermination. For rules covering agreements with respect to useful life, see section 167(d) and § 1.167(d)-1.

(c) *Salvage*. Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b), salvage value may be redetermined based upon facts known at the time of such redetermination of useful life. Salvage, when reduced by the cost of removal, is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. How-

ever, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value. Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See, however, § 1.167(b)-2(a) for the treatment of salvage under the declining balance method. The taxpayer may use either salvage or net salvage in determining depreciation allowances but such practice must be consistently followed and the treatment of the costs of removal must be consistent with the practice adopted. For specific treatment of salvage value see §§ 1.167(b)-1, 2, and 3. When an asset is retired or disposed of, appropriate adjustments shall be made in the asset and depreciation reserve accounts. For example, the amount of the salvage adjusted for the costs of removal may be credited to the depreciation reserve.

SEC. 1.167(b)-0. *Methods of computing depreciation.*—

(a) *In general.* Any reasonable and consistently applied method of computing depreciation may be used or continued in use under section 167. Regardless of the method used in computing depreciation, deductions for depreciation shall not exceed such amounts as may be necessary to recover the unrecovered cost or other basis less salvage during the remaining useful life of the property.

SEC. 1.167(b)-1. *Straight line method.*—

(a) *Application of method.* Under the straight line method the cost or other basis of the property less its estimated salvage value is deductible in equal annual amounts over the

period of the estimated useful life of the property. The allowance for depreciation for the taxable year is determined by dividing the adjusted basis of the property at the beginning of the taxable year, less salvage value, by the remaining useful life of the property at such time. For convenience, the allowance so determined may be reduced to a percentage or fraction. The straight line method may be used in determining a reasonable allowance for depreciation for any property which is subject to depreciation under section 167 and it shall be used in all cases where the taxpayer has not adopted a different acceptable method with respect to such property.

* * * * *

Treasury Regulations 103, promulgated January 29, 1940, under the Internal Revenue Code of 1939:

SEC. 19.23(1)-1. Depreciation.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the cost or other basis of the property determined in accordance with section 113. * * *

FILE COPY

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1959

No. 143 /

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER

VS.

ROBLEY H. EVANS AND JULIA M. EVANS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 25, 1959
CERTIORARI GRANTED OCTOBER 12, 1959

No. 15985

United States
Court of Appeals
for the Ninth Circuit

ROBLEY H. EVANS and JULIA M. EVANS,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of Record

**Petition to Review a Decision of the Tax Court
of the United States**

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

ROSWELL MAGILL,
15 Broad St.,
New York, New York;

LYLE L. IVERSEN,
Hoge Bldg.,
Seattle, Washington;

DONALD J. YELLON,
33 North LaSalle St.,
Chicago, Illinois,

For Petitioners.

CHARLES K. RICE,
Asst. U.S. Attorney General;

LEE A. JACKSON,
Atty., Dept of Justice,
Washington 25, D. C.;

For Respondent.

The Tax Court of The United States

Docket No. 58067

ROBLEY H. EVANS AND JULIA M. EVANS,
Husband and Wife,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above-named petitioners hereby petition for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency, bearing symbols Ap:S:AA:90D-PAD:-JHR, dated March 9, 1955, and as a basis of their proceeding allege as follows:

1. Petitioners are individuals residing at 604 84th Avenue N. E., Bellevue, Washington, their mailing address being 1413 Seventh Avenue, Seattle 1, Washington. The returns for the years here involved were filed with the Collector of Internal Revenue for the District of Washington.

2. The notice of deficiency, a copy of which is attached hereto, marked Exhibit "A," was mailed to petitioners on March 9, 1955.

3. The deficiencies as determined by the Commissioner are in income taxes for the calendar years ended December 31, 1950, and December 31,

1951, in the respective amounts of \$32,847.62 and \$49,514.04, a total of \$82,361.66 for both years. The entire amount of the deficiencies is in dispute.

4. The determination of taxes set forth in the said notice of deficiency is based upon the following errors:

I. The respondent erred in his determination that depreciation on automobiles in the year 1950 was excessive in the amount of \$56,114.09, thereby increasing business income by this amount.

II. The respondent erred in his determination that petitioners were in the business of selling used automobiles during the year 1950; that the profit realized from the sale of these automobiles was income from the sale of property held primarily for sale in the ordinary course of their business; and in increasing their business income by the amount of the alleged profit on the sale of these automobiles in the amount of \$17,061.62.

III. The respondent erred in his determination that the automobiles sold in 1950 which had been held for more than six months were not assets used in the trade or business of a character which is subject to the allowance for depreciation and thereby eliminating the gain on the sale of these automobiles as gain from the sale of capital assets.

IV. The respondent erred in his determination that depreciation on automobiles in the year 1951

was excessive in the amount of \$62,515.92, thereby increasing business income by this amount.

V. The respondent erred in his determination that petitioners were in the business of selling used automobiles during the year 1951; that the profit realized from the sale of these automobiles was income from the sale of property held primarily for sale in the ordinary course of their business; and in increasing their business income by the amount of the alleged profit on the sale of these automobiles in the amount of \$5,813.53.

VI. The respondent erred in his determination that attorney fees in the amount of \$2,500.00 claimed as a deduction in 1951 were attributable to the sale of real estate, thereby increasing income from the automobile business and decreasing the gain on the sale of houses and lots.

VII. The respondent erred in his determination that a loan made by petitioners to the Aero-U-Drive in the amount of \$3,500.00, which became worthless in 1951, was a non-business bad debt.

VIII. The respondent erred in his determination that petitioners realized ordinary income in the amount of \$40,059.33 from the sale of lots in the year 1951 which the respondent alleges were held primarily for sale to customers in the course of petitioners' business.

IX. The respondent erred in his determination that only \$4,136.75 of the total profit realized on

the sale of lots, including petitioners' personal residence, was allocable to the sale of the personal residence.

X. Respondent erred in his determination that the automobiles sold in 1951 which had been held for more than six months were not assets used in the trade or business of a character which is subject to the allowance for depreciation and thereby eliminating the gain on sale of these automobiles as gain from the sale of capital assets.

5. The facts upon which petitioners relied as a basis of this proceeding are as follows:

(a) During the years 1950 and 1951 petitioners were engaged in the auto leasing business and were not engaged in the business of selling used cars. The sale of automobiles during these years was the result of their being unusable in the car leasing business. Gross rentals received from the auto leasing business during the years 1950 and 1951 were in the respective amounts of \$109,935.00 and \$132,840.00.

(b) Depreciation in the respective amounts of \$77,972.71 and \$92,890.05 for the years 1950 and 1951 was claimed on petitioners' tax returns for these years. Depreciation was computed on the basis that these automobiles had an estimated useful life of four years.

(c) Respondent has recomputed the amount of allowable depreciation on automobiles for the years

1950 and 1951 using an estimated useful life of seventeen months and a salvage value of \$1,325.00, or the amount of undepreciated cost at January 1, 1950, if less than \$1,325.00.

(d) In the auto leasing business the public demands automobiles less than two years old when new cars are available. Therefore, in order to meet competition it was necessary for petitioners to follow a policy of disposing of automobiles when possible before they were two years old. Gains and losses on the sale of these automobiles have been reported by petitioners for both years, 1950 and 1951, as gains and losses on the sale of assets used in the trade or business of a character subject to the allowance for depreciation.

(e) Attorney fees paid in the year 1951 in the amount of \$2,500.00 were for services in connection with petitioners' normal business operations as well as in connection with the sale of real estate.

(f) Petitioners loaned to Aero-U-Drive, Inc., a total of \$3,500.00 represented by three notes. These notes are in the amounts of \$1,000.00, \$1,000.00 and \$1,500.00, and are dated December 17, 1948, January 10, 1949, and November 1, 1949, respectively. These notes became worthless in 1951.

(g) During the year 1943 and the years subsequent thereto, petitioners acquired approximately 74½ acres of undeveloped land near Bellevue, Washington. Petitioners maintained their residence

on the property and operated a part of the property as a farm.

(h) In the early part of 1950, petitioners transferred this property to a corporation known as the Surrey Development Company which was formed for the purpose of developing and selling real estate.

(i) The Surrey Development Company started the work necessary to establish a residential subdivision. The results of the exploratory work were not encouraging, and the management could not foresee the probability of a successful enterprise.

(j) In March 1951, Surrey Development Company was liquidated and the venture abandoned. As a result of the liquidation, carried out under Section 112(b)(7) of the Internal Revenue Code (1939), petitioners reacquired title to the property.

(k) With the exception of one lot, the entire tract, including petitioners' personal residence, was sold to Louisa C. Frye, Inc., in April, 1951.

(l) In March, 1950, petitioners, as individuals, became engaged in the home construction business under the name of Bellevue Builders. During the year 1950 an experimental house was built. The house was on a lot purchased from Surrey Development Company. The house was sold in January, 1951, at a loss of \$3,514.22.

Wherefore, petitioners pray that this Court may hear the proceeding and that the case be set for

trial at Seattle, Washington; that it find that the respondent has erred in the respects and to the extent stated in paragraph 4, supra; that this Honorable Court may enter its order accordingly; and that it give such other and further relief as, in the judgment of this Court, may be fit and proper.

LYCETTE, DIAMOND AND
SYLVESTER,

/s/ JOHN P. LYCETTE,
Attorney;

PEAT, MARWICK,
MITCHELL & CO.,

/s/ HAROLD L. SCOTT,
C. P. A.,
Counsel for Petitioners.

Duly verified.

EXHIBIT A

123 U. S. Court House
Seattle 4, Washington

Mar. 9, 1955.

Ap :S:AA :90D
PAD:JHR

Mr. Robley H. Evans and Mrs. Julia M. Evans,
Husband and Wife,
1413 Seventh Avenue,
Seattle 1, Washington.

Dear Mr. and Mrs. Evans:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1950, and December 31, 1951, discloses a deficiency or deficiencies of \$82,361.66 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days from the date of the mailing of this letter you may file a petition with The Tax Court of the United States, at its principal address, Washington 4, D. C., for a redetermination of the deficiency. In counting the 90 days you may not exclude any day unless the 90th day is a Saturday, Sunday, or legal holiday in the District of Columbia in which event that day is not counted as the 90th day. Otherwise Saturdays, Sundays, and legal holidays are to be counted in computing the 90-day period.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Assistant Regional Commissioner, Appellate, 123 U. S. Court House, Seattle 4, Washington. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after receipt of the form, or on the date of assessment, or on the date of payment, whichever is the earlier.

Very truly yours,

T. COLEMAN ANDREWS,
Commissioner,

By /s/ JAMES E. WESTIN,
Associate Chief, Appellate
Division.

Enclosures:

Statement.

Form 1276.

Agreement Form.

JHResler:mkn.

Ap:S:AA:90D

PAD:JHR

Statement

Mr. Robley H. Evans and Mrs. Julia M. Evans
Husband and Wife
1413 Seventh Ave.
Seattle 1, Wash.

Tax Liability for the Taxable Years Ended December 31, 1950
and December 31, 1951

Year	Kind of Tax	Deficiency
1950	Income	\$32,847.62
1951	Income	49,514.04
Total		<u>\$82,361.66</u>

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated August 12, 1953; to your protest dated April 20, 1954, and to the statements made at the conferences held on October 21, 1954, January 19, 1955, and February 23, 1955.

It has been determined that the average useful life of automobiles used in your business based on your actual experience was not in excess of seventeen months and the average salvage value of said automobiles at the end of their useful life in your business was not less than \$1,325.00 or the adjusted basis of said automobiles as of January 1, 1950, whichever amount was the lesser. A computation of allowable depreciation on this basis has been made in Exhibit A of this statement wherein it is shown that excessive depreciation was claimed as follows:

Year ended December 31, 1950

Depreciation on automobiles claimed on return	\$77,972.71
Depreciation on automobiles allowable.....	21,858.62
Excessive depreciation—1950	\$56,114.09

Year Ended December 31, 1951

Depreciation on automobiles claimed on return.....	\$92,890.05
Depreciation on automobiles allowable.....	30,374.13
Excessive depreciation—1951	\$62,515.92

It is further held that you were also in the business of selling used automobiles during the years 1950 and 1951. Consequently, the profit realized from the sale of the automobiles was income from the sale of property held primarily for sale in the ordinary course of your business within the meaning of section 117(j) of the Internal Revenue Code and such income may not be treated as a capital gain under the above-mentioned section of the Code. Accordingly your income from automobile business has been increased by the net profit from the sale of automobiles as computed in Exhibit A which amounted to \$17,061.62 for the year 1950 and \$5,813.53 for the year 1951. Correspondingly, your net income for 1950 and 1951 has been decreased by the amount of net capital gain from sales of automobiles which was reported on your return for 1950 in the amount of \$17,867.84 and on your return for 1951 in the amount of \$26,107.93.

A copy of this letter and statement has been mailed to your representative, Mr. Harold L. Scott, 951 Stuart Bldg., Seattle 1, Washington, in accordance with the authority contained in the power of attorney executed by you.

Taxable Year Ended December 31, 1950

Adjustments to Net Income

Net income as disclosed by return.....	\$ 44,016.22
Unallowable deductions and additional income:	
(a) Business income	73,175.71
Total	<u>\$117,191.93</u>
Nontaxable income and additional deductions:	
(b) Capital gains	17,867.84
Net income adjusted	<u><u>\$ 99,324.09</u></u>

Explanation of Adjustments

(a) Excessive depreciation claimed on automobiles, Exhibit A	\$56,114.09
Ordinary income from sale of automobiles as now determined, Exhibit A	17,061.62
Additional business income	<u>\$73,175.71</u>
(b) Capital gain eliminated as explained above	<u>\$17,867.84</u>

Computation of Tax

Net income adjusted	\$99,324.09
Less: Exemptions (3 x \$500.00)	<u>1,800.00</u>
Income subject to tentative tax	\$97,524.09
One-half of above income	<u>\$48,762.05</u>
Tentative tax on \$48,762.05	\$25,928.68
Less: Reduction (\$52.00 plus 9% of \$25,528.68)	<u>2,349.58</u>
Combined normal tax and surtax	\$23,579.10
Income tax liability (\$23,579.10 multiplied by 2)	<u>\$47,158.20</u>
Liability disclosed by return, Orig. acct. no. 9105156	14,310.58
Deficiency of income tax	<u>\$32,847.62</u>

Taxable Year Ended December 31, 1951

Adjustments to Net Income

Net income as disclosed by return		\$ 45,162.61
Unallowable deductions and additional income:		
(a) Income from automobile business	\$77,843.67	
(b) Income from real estate development operations	36,545.11	114,388.78
Total		<u>\$163,551.39</u>
Nontaxable income and additional deductions:		
(c) Capital gains		42,802.59
Net income adjusted		<u><u>\$120,748.80</u></u>

Explanation of Adjustments

(a) Income from automobile business	\$77,843.67
Income from automobile business as now determined	\$86,203.69
As reported on your return	8,360.02
Additional income	<u>\$77,843.67</u>

Summary

Profit reported on return	\$ 8,360.02
Plus: 1. Excessive depreciation claimed on automobiles—Exhibit A	62,515.92
2. Ordinary income from sales of automobiles Exhibit A	5,813.53
3. Loss from sale of house	3,514.22
4. Legal expense	2,500.00
5. Bad debt	3,500.00
Total	<u><u>\$86,203.69</u></u>

Explanation of Items

1. & 2. As explained above.
3. A loss of \$3,514.22 from the sale of a house constructed by you and sold in the course of your business of selling houses

and lots, for the purpose of clarification, has been eliminated from deductions attributable to automobile business and included as a deduction from income from sale of houses and lots.

4. It is held that attorney's fee, \$2,500.00 was attributable to the sale of real estate and has therefore been eliminated from deductions attributable to automobile business and included as a deduction from income from sale of houses and lots.

5. A loan of \$3,500.00 to the Aero U-Drive, a corporation, which became worthless in 1951 is held to be a nonbusiness bad debt. Therefore the amount has been eliminated from the deductions attributable to automobile business and treated as a short-term capital loss as shown below.

(b) It has been determined that you realized ordinary income in the amount of \$36,545.11 from the sale of lots and a house which were held primarily for sale to customers in the course of your business. Therefore, your net income has been increased by the above amount and the amount of capital gain reported from this source is eliminated as shown below. The corrected computation of income from sale of houses and lots is as follows:

1. Gain from sale of lots.....\$40,059.33
2. Loss from sale of house as explained above (3,514.22)

\$36,545.11

Explanation of Items

1. Sales price of lots including personal- residence	\$100,000.00
Cost	\$56,773.99
Less: Depreciation from buildings allowed	3,680.07
Adjusted cost	\$53,093.92
Expense of sale per return \$	210.00
Attorney's fee as men- tioned above	2,500.00 2,710.00
Net cost	55,803.92
Total profit	\$ 44,196.08

Portion of profit allocable to sale of personal residence which is not includible in income because a new residence was purchased on January 30, 1952 for \$26,000.00:

Market value of old residence at date of sale, April 12, 1951

\$9,360.00

9360

100000 of \$44,196.08.....

4,136.75

Gain from sale of lots

\$ 40,059.33

2. For explanation, see Item 3, supra.

- (c). It is held that a capital loss of \$1,000.00 is allowable for the year 1951. Inasmuch as a net capital gain of \$41,802.59 was reported on your return, your net income has been decreased by the difference, \$42,802.59. A computation of the corrected capital loss and capital loss carry-forward is as follows:

Net capital gain per return \$41,802.59

Less: Amount reported as capital gain from sale of autos..... \$26,107.94

Amount reported as capital gain from sale of lots..... 16,204.65

Short-term loss from non-business bad debt as explained above 3,500.00

\$45,812.59

Add: Loss of \$510.00 was claimed as short-term loss whereas amount should have been deducted as a long-term capital loss since the stock was held more than six months—50%

of \$510.00 255.00

Net adjustment

45,557.59

Commissioner of Internal Revenue

17

Net capital loss before limitation....	\$ 3,755.00
Limited to	1,000.00
Capital loss carry-over to sub- sequent year	<u>\$ 2,755.00</u>

Computation of Tax

Net income adjusted	\$120,748.80
Less: Exemptions (3 x \$600.00)	1,800.00
Income subject to tentative tax	<u>\$118,948.80</u>
One-half of income subject to tentative tax	<u>\$ 59,474.40</u>
Combined normal tax and surtax on \$59,474.42	<u>\$ 34,301.80</u>
Income tax liability (\$34,301.80 multiplied by 2)	\$ 68,603.60
Self-employment tax	81.00
Total tax liability	<u>\$ 68,684.60</u>
Liability disclosed by return, ,	
Orig. acct. no. BC-393	19,170.56
Deficiency of income tax	<u>\$ 49,514.04</u>

Received and filed May 31, 1955, T.C.U.S.

Served June 1, 1955.

[Title of Tax Court and Cause.]

ANSWER

Comes Now the Commissioner of Internal Revenue, by his attorney, John Potts Barnes, Chief Counsel, Internal Revenue Service, and for answer to the petition filed herein, admits and denies as follows:

1. Admits the allegations of paragraph 1 of the petition.

2. Admits the allegations of paragraph 2 of the petition.

3. Admits the allegations of paragraph 3 of the petition.

4. I to X, inclusive. Denies that the respondent erred in his determination of deficiencies as shown by the statutory notice of deficiency from which the petitioners' appeal is taken. Specifically denies that he erred in the manner and form as alleged in paragraphs 4. I to X, inclusive, of the petition.

5. (a) Admits that during the years 1950 and 1951 petitioners were engaged in auto leasing. Denies the remaining allegations of paragraph 5. (a) of the petition.

(b) Denies the allegations of paragraph 5. (b) of the petition.

(c) Admits the allegations of paragraph 5. (c) of the petition.

(d) Admits that petitioners reported gains and losses on the sale of automobiles for 1950 and 1951. Denies the remaining allegations of paragraph 5. (d) of the petition.

(e) Denies the allegations of paragraph 5. (e) of the petition.

(f) Admits that petitioners loaned to Aero-U-Drive, Inc., a total of \$3,500.00, which loan became

worthless in 1951. Denies the remaining allegations of paragraph 5. (f) of the petition.

(g) Admits that during the year 1943, petitioners acquired approximately 741½ acres of undeveloped land near Bellevue, Washington. Denies the remaining allegations of paragraph 5. (g) of the petition.

(h) Admits that in the early part of 1950, petitioners transferred this property to a corporation known as the Surrey Development Company. Denies the remaining allegations of paragraph 5. (h) of the petition.

(i) Denies the allegations of paragraph 5. (i) of the petition.

(j) Admits that in March, 1951, Surrey Development Company was liquidated, and that petitioners reacquired title to the property. Denies the remaining allegations of paragraph 5. (j) of the petition.

(k) Admits that with the exception of one lot, the entire tract was sold to Louisa C. Frye, Inc., in April, 1951. Denies the remaining allegations of paragraph 5. (k) of the petition.

(l) Admits the allegations of paragraph 5. (l) of the petition.

6. Denies generally each and every allegation of the petition not hereinabove specifically admitted, qualified or denied.

Wherefore, it is prayed that the Court hear this proceeding and determine and hold that the petition be denied, that respondent's determination be in all respects approved and that respondent be granted such other relief as the Court may deem proper in the premises.

/s/ JOHN POTTS BARNES, WHP
Chief Counsel,
Internal Revenue Service.

Of Counsel:

MELVIN L. SEARS,
Regional Counsel;

JOHN H. WELCH,
Special Attorney,
Internal Revenue Service.

Filed June 6, 1955, T. C. U. S.

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed between the Commissioner of Internal Revenue and the above-entitled petitioners, by their respective undersigned attorneys, that the following facts shall be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance with the facts herein stipulated, or to object to the introduction in evi-

dence of any such facts on the grounds of immateriality or irrelevancy.

1. Petitioners are individuals residing at 604 84th Avenue N. E., Bellevue, Washington, their mailing address being 1413 Seventh Avenue, Seattle 1, Washington. They are husband and wife, constituting a marital community under the laws of the State of Washington. The returns for the years here involved were filed with the Collector of Internal Revenue for the District of Washington.

2. A notice of deficiency, a copy of which is attached to the petition marked Exhibit "A," was mailed to Petitioners on March 9, 1955.

3. The deficiencies, as determined by the Commissioner, are in income taxes for the calendar years ended December 31, 1950, and December 31, 1951, in the respective amounts of \$32,847.62 and \$49,514.04 a total of 82,361.66 for both years. The entire amount of the deficiencies is in dispute.

4. During the years 1950 and 1951 the petitioner, Robley H. Evans, who acted on behalf of the marital community, and who will hereafter be referred to as though he were the sole petitioner, was engaged in the business of leasing automobiles in Seattle, Washington. During the years involved petitioner owned automobiles involved in the case which were leased to Evans-U-Drive, Inc., a corporation, all of whose outstanding corporate stock was held by petitioner's son, Robert J. Evans until near the end of 1951 at which time petitioner

acquired a portion of the stock. Petitioner was employed by the corporation as its manager. All vehicles leased to Evans U-Drive, Inc., were paid for by that corporation to petitioner on the basis of \$45.00 per month per car.

5. During the years 1950 and 1951 petitioner sold certain automobiles at the respective times and at the respective selling prices set forth in Exhibit "A" to that certain notice to Taxpayer from the Commissioner of Internal Revenue dated March 9, 1955, bearing symbols Ap :S:AA :90D-PAD-JHR, Taxpayer having purchased said automobiles at the respective dates and at the respective purchase prices set forth in said Exhibit.

6. Depreciation, in the respective amounts of \$77,972.71 and \$92,890.05 for the years 1950 and 1951 was claimed on petitioner's tax returns for these years. Depreciation was computed on the basis that these automobiles had an estimated useful life of four years, with no salvage value, at the end of the four-year period.

7. Respondent has computed the amount of allowable depreciation on automobiles for the years 1950 and 1951 using an estimated useful life of 17 months and a salvage value of \$1,325.00, or the amount of undepreciated cost at January 1, 1950, if less than \$1,325.00.

8. For the years 1950 and 1951 petitioner has reported gains and losses on the sale of automobiles as gains and losses on the sale of assets used in the

trade or business of a character subject to an allowance for depreciation.

9. Petitioner loaned to Aero U-Drive, Inc., a total of \$3,500 represented by three notes. These notes are in the amounts of \$1,000, \$1,000, and \$1,500 and are dated December 17, 1948, January 10, 1949, and November 1, 1949, respectively. These notes became worthless in 1951.

10. During the year 1943 and years subsequent thereto, petitioners acquired approximately 74 $\frac{1}{2}$ acres of undeveloped land near Bellevue, Washington. Petitioners maintained their residence on the property and operated a part of the property as a farm.

11. In the early part of 1950 petitioners transferred this property to a corporation known as the Surrey Development Company which was formed for the purpose of developing and selling real estate.

12. In March, 1951, Surrey Development Company was liquidated and petitioners reacquired the title to the property. The liquidation was carried out under Section 112 (b)(7) of the Internal Revenue Code of 1939.

13. With the exception of one lot the entire tract, including petitioners' personal residence was sold by petitioner to Louisa C. Frye, Inc., in April, 1951, for \$100.00. Petitioner purchased a new personal residence on January 30, 1952, for \$26,600.00.

14. In March, 1950, petitioner, as an individual, became engaged in the home construction business

under the name of "Bellevue Builders." During the year 1950 an experimental house was built. The house was on a lot purchased from Surrey Development Company. The house was sold in January, 1951, at a loss of \$3,514.22.

15. Original tax returns filed by petitioner with respondent, if placed in evidence, may be withdrawn and photostatic copies substituted with underlining in red to indicate figures typed in red upon such returns.

/s/ LYLE L. IVERSEN,

Attorney for Petitioners;

/s/ HERMAN T. REILING, WHP

Acting Chief Counsel, Internal Revenue Service,
Counsel for Respondent.

Filed at hearing February 5, 1957.

[Title of Tax Court and Cause.]

FINDINGS OF FACT AND OPINION

Petitioner was engaged in the business of leasing automobiles. During the taxable years he leased all of his automobiles to U-Drive. U-Drive leased automobiles to customers for extended periods of time and rented automobiles to the public for short periods of time. U-Drive's business required that petitioner keep it well stocked with late model, modernly equipped automobiles. The leased automo-

biles were returned to him at the termination of the leases and the rented automobiles were usually returned within 15 months of their original purchase by petitioner. Petitioner sold these automobiles immediately. Held, useful life and salvage value of the automobiles determined, for the purpose of depreciation.

LYLE L. IVERSEN, ESQ., AND
DONALD J. YELLON, ESQ.,

For the Petitioners.

JOHN H. WELCH, ESQ.,

For the Respondent.

Memorandum Findings of Fact and Opinion

Tietjens, Judge:

The Commissioner determined deficiencies in the petitioners' income taxes for the years 1950 and 1951 in the respective amounts of \$32,847.62 and \$49,514.04. The petitioners conceded that certain adjustments made by the Commissioner were correct. The Commissioner also conceded that certain of his adjustments were improper. The only issue left for our decision arises from the Commissioner's partial disallowance of claimed depreciation deductions. He determined that automobiles used in the petitioners' business had a shorter useful life than claimed and also a salvage value. A stipulation of certain issues in controversy was filed by the parties. It is incorporated herein by this reference.

Findings of Fact

The stipulated facts are so found and are incorporated herein by reference.

The petitioners, Robley H. Evans and Julia M. Evans, are husband and wife. They reside in Bellevue, Washington, and filed their joint income tax returns for the years 1950 and 1951 with the collector of internal revenue for the district of Washington.

During the years 1950 and 1951 Robley was engaged in the business of leasing automobiles in the vicinity of Seattle. He has been in that business as a proprietor since 1936. During 1950 and 1951 Robley leased all of his automobiles to Evans U-Drive, Inc., (hereinafter referred to as U-Drive) a corporation, at the rate of \$45 per month per automobile.

U-Drive was organized in 1949. All of its outstanding stock was held by Robley's son, Robert J. Evans, until near the end of 1951 at which time Robley acquired a portion of the stock. Robley was the manager of U-Drive.

The lease agreement between Robley and U-Drive provided that Robley would furnish and lease to U-Drive a sufficient number of automobiles to efficiently operate and conduct an automobile rental business. Robley retained title to the automobiles and had the right to sell and dispose of any of the automobiles at any time. U-Drive agreed to pay all expenses of maintenance and repair of the auto-

mobiles and also to keep the automobiles insured against liability for personal injury or property damage. U-Drive also assumed the risk of loss or damage. A supplemental agreement dated December 1, 1951, gave U-Drive an option to purchase any automobile in its possession at any time, for the actual cost of the automobile to Robley.

U-Drive engaged in two types of activity during the taxable years. It leased about 30 to 40 per cent of its automobiles to customers for long periods of time, i.e., 18 to 36 months and it rented the remainder of its automobiles to the general public on a short-term basis, i.e., for a few hours, a few days, or a few weeks.

Robley normally kept a supply of Chevrolet, Ford and Plymouth automobiles on hand, which he purchased new from local automobile dealers, usually at the factory price. He endeavored to maintain a modern fleet of rental automobiles as this was necessary to meet the demands of U-Drive's leasing and rental business.

Robley periodically owned more automobiles than were necessary for the efficient operation of U-Drive's short-term rental business. When this situation occurred, he would examine the cars in use and would sell those that were not needed. The oldest and least desirable automobiles were sold first. When sold, the automobiles usually had been driven an average of 15,000 to 20,000 miles and were generally in good mechanical condition. Many auto-

mobiles were sold at the end of the tourist season, i.e., after Labor Day.

At the termination of U-Drive's extended period leases, the automobiles would be returned to Robley who would sell them. When sold, the automobiles might have been driven up to 50,000 miles. They were usually in good mechanical condition and state of repair at the time of sale.

The surplus automobiles sold by Robley could have been used longer than they were; however, customers demanded late model automobiles that were currently in style. Older automobiles did not have much value as rental vehicles. During the taxable years, Robley sold the automobiles used by U-Drive in the short-term rental phase of its business after they had been used about 15 months. And he usually sold the automobiles which had been leased for extended periods as soon as the lease was terminated. If a new lease was executed, a new car was usually provided for the lessee.

Robley sold most of his surplus automobiles to used car dealers, jobbers, or brokers. As a general rule, the automobiles were sold at current wholesale prices. Robley did not advertise the sales of his automobiles nor did he maintain a showroom or any other retail facilities for sale of his surplus automobiles.

Robley's tax returns for 1950 and 1951 disclosed that he sold 140 and 147 automobiles, respectively, in those years. The average cost, sales price, de-

preciation claimed, and gain per automobile, were approximately as follows:

Year	Cost	Sales Price	Depreciation Claimed	Gain
1950.....	\$1,650	\$1,380	\$515	\$245
1951.....	1,495	1,395	450	350

Most of the automobiles sold had been held by Robley less than 15 months.

On his tax returns for the years 1950 and 1951 Robley claimed depreciation on the automobiles he leased to U-Drive in the respective amounts of \$77,972.71 and \$92,890.05. These amounts were computed and the deductions claimed on the basis that the automobiles had an estimated useful life of 4 years, with no salvage value at the end of the 4-year period.

The Commissioner determined allowable depreciation on these automobiles for the years 1950 and 1951 on the basis of an estimated useful life for each automobile of 17 months and a salvage value of \$1,325 at the end of the 17-month period, or the amount of undepreciated cost at January 1, 1950, for automobiles in use at that date, if less than \$1,325.

The automobiles leased to U-Drive during the taxable years for use under extended term leases, had a useful life of 3 years and a salvage value of \$600. However, if the undepreciated cost of such automobiles in service at January 1, 1950, is less than \$600, then that amount will be the salvage value of those automobiles.

The automobiles leased to U-Drive during the taxable years for short-term rental use, had a useful life of 15 months and a salvage value of \$1,375. However, if the undepreciated cost of such automobiles in service at January 1, 1950, is less than \$1,375, then that amount will be the salvage value of those automobiles.

Opinion

The sole question for decision relates to the rate of depreciation to be used by Robley upon automobiles used by him in his business of leasing automobiles to U-Drive, a corporation owned solely by his son until the latter part of 1951, at which time Robley acquired a portion of the stock. U-Drive engaged in two types of activities. It leased about 30 to 40 per cent of its automobiles to customers for extended periods of time (18 to 36 months) and it rented the remainder of its automobiles to the public for short periods of time (a few hours, days, or weeks).

Section 23(1) of the Internal Revenue Code of 1939 provides for the deduction of a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business.

Regulations 111, Section 29.23(1) provide that the proper allowance for depreciation is that amount which should be set aside for the taxable year whereby the aggregate of the amounts so set aside, plus the salvage value will, at the end of the

useful life of the property, equal the cost on other basis of the property. See also *United States v. Ludley*, 274 U. S. 295 (1927). The reasonableness of depreciation claimed is to be determined in the light of conditions known to exist at the end of the period for which the return is made. *Leonard Refineries, Inc.*, 11 T.C. 1000 (1948).

Robley has consistently claimed deductions for depreciation on the basis that his automobiles had a useful life of 4 years, with no salvage value at the end of the 4-year period. The Commissioner however determined allowable depreciation on Robley's automobiles for the taxable years on the basis of an estimated useful life of 17 months and a salvage value of \$1,325, or the amount of undepreciated cost at the beginning of the first taxable year for automobiles in use at that date, if less than \$1,325.

Robley has engaged in the business of leasing automobiles as a sole proprietor since 1936. During World War II and for several years thereafter, automobiles were scarce and Robley was forced to use his automobiles for long periods of time before selling them and acquiring new ones. Depreciation claimed by Robley on the basis of a useful life of 4 years may not have been unreasonable during that period, though we think he still should have provided for a salvage value in his computation.

However, in 1949, when new automobiles were more easily obtainable, Robley's son organized U-

Drive, and Robley began leasing all of his automobiles to that corporation. Robley's lease agreement with U-Drive provided that he would furnish and lease a sufficient number of automobiles to operate and conduct an automobile rental business efficiently. To carry out the lease, Robley thus had to provide automobiles to U-Drive with which ~~the~~ latter could meet competition and that competition required him to furnish U-Drive with late model automobiles with modern equipment, i.e., automatic transmissions, etc.

Robley would furnish new automobiles to U-Drive for its extended period leases. At the termination of those leases some 18 to 36 months later, the automobiles would be returned to Robley who would then sell them. If the customer renewed his lease, he would be provided with another new automobile. Current model automobiles were provided for the short-term rentals. Many of these were returned to Robley at the end of the tourist season, when demand for rental automobiles subsided, and they were sold by him at that time. Robley would start to purchase new model automobiles as soon as they came on the market in order to replenish his fleet and would continue doing so, as required by U-Drive's needs. Thus Robley was continually buying new automobiles and selling "old" ones as they were returned to him by U-Drive even though many of the latter automobiles were barely "broken in." U-Drive's competition required this method of operation and in view of

this change in Robley's operations, we think that the Commissioner was justified in adjusting Robley's method of depreciating his automobiles. However, we think that the Commissioner's adjustment should have taken into consideration the two different uses made of the automobiles leased to U-Drive, i.e., extended-term leases and short-term rentals.

We have made a finding, and we so hold, that the automobiles which Robley leased to U-Drive during the taxable years for use under extended term leases, had a useful life of 3 years and a salvage value of \$600, and that the automobiles which it leased to U-Drive for short-term rentals had a useful life of 15 months and a salvage value of \$1,375. If the undepreciated cost of the automobiles in service at January 1, 1950, is less than \$600 and \$1,375 for the respective classes of automobiles, then that amount will be the salvage value of those automobiles. See J. W. McWilliams, 15 B.T.A. 329 (1929).

Decision will be entered under Rule 50.

Filed: July 31, 1957.

Entered: August 1, 1957.

Served: August 1, 1957.

Tax Court of The United States
Washington

Docket No. 58067

ROBLEY H. EVANS AND JULIA M. EVANS,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion, filed July 31, 1957, the petitioners and respondent filed differing computations of tax. Hearing was had on February 5, 1958, at which counsel for petitioners and respondent were present, and petitioners filed an amended computation. After due consideration, it appearing that the amended computation filed by the petitioners is consonant with the determination of the Court and that the computation filed by the respondent is not, the petitioners' amended computation is approved, and it is

Ordered and Decided: That there are deficiencies in income tax for the years 1950 and 1951 in the respective amounts of \$13,191.52 and \$13,048.12.

[Seal] /s/ **NORMAN O. TIETJENS**,
Judge.

Entered: February 7, 1958.

Served: February 10, 1958.

The Tax Court of the United States

Docket No. 58067

In the Matter of: _____

ROBLEY H. EVANS, et al.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

TRANSCRIPT OF PROCEEDINGS

Tuesday, February 5, 1957

The above-entitled matter came on for hearing,
pursuant to Calendar Call, at 9:45 o'clock a.m.

Before: The Honorable Norman O. Tietjens.

Appearances:

LYLE L. IVERSEN,

DONALD J. YELLON,

On Behalf of the Petitioner.

JOHN H. WELCH,

On Behalf of the Respondent.

* * *

Proceedings

The Clerk: Docket No. 58067, Robley H. Evans.
State your appearances, please.

Mr. Iversen: I am Lyle L. Iversen, and there is Mr. Donald J. Yellon.

Mr. Welch: John H. Welch, appearing for the Respondent.

The Court: Do you wish to make an opening statement, please?

OPENING STATEMENT ON BEHALF OF THE PETITIONER

By Mr. Iversen:

We have arrived at a stipulation of a portion of the facts and I will hand in that stipulation now. The stipulation is as to so many of the facts as we have been able to agree upon and, of course, is not a complete stipulation of facts.

This action involves several different issues in regard to the taxpayer's returns for the years 1950 and '51. These issues are somewhat different and to a considerable extent unrelated, and consequently we propose to take them up one by one so we can keep the issues somewhat separated. [4*]

* * *

During the time that this was going on, the Petitioner was engaged regularly, in his regular employment, which is the renting and leasing of automobiles at Seattle. [4-A]

* * *

Now we come to the next issue, and this is a rather distinguished issue from the ones I have previously covered.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

The taxpayer, we will show, has been for a number of years engaged in the business of leasing and renting automobiles [6] in the City of Seattle. Now, this question involves, the next issue involves the question of capital gains on these automobiles when they are disposed of and also the question of the depreciation of these automobiles. Our evidence will show that he customarily purchases automobiles for the purposes of the leasing and renting operations which are distinguishing in that leasing is where they let out a car to a particular customer for a term in excess of a year, and renting is the ordinary casual rental where the customer comes in and takes the car for a day or for a shorter period. He buys these cars and they are used in this business and after a period they become excess to the business and are disposed of. Evidence will show that the petitioner during the years 1950 and '51 had an arrangement with a corporation, Evans-U-Drive, Incorporated. During most of the period the stock in that corporation was held entirely by his son. During the latter part of the period he acquired a portion of it, but at all times he was manager of Evans-U-Drive, Incorporated, but in his own capacity he purchased the cars and leased them to Evans-U-Drive, Incorporated, at a rate of 45 per month per car. When the needs of the Evans-U-Drive dictated, cars were purchased and when the needs of Evans-U-Drive dictated cars were disposed of as surplus. We will show that in the disposition of these cars retail sales were not made. He had no retail facilities and the manner of disposing of them was,

generally inquiries would come from [7] wholesale dealers who knew from time to time there would be cars to be disposed of here and these dealers would inquire and the cars would be sold to the dealers at wholesale prices, and that the disposition of the cars was dictated strictly by the needs of the rental and leasing business and that frequently these sales were made at times at the lowest wholesale prices and generally with regard solely to the leasing and rental business rather than to the wholesale market.

Our evidence will show that these were depreciable property used in the business under Section 117, that they were held over six months and the taxpayer claimed capital gains on the proceeds of the sales of these cars.

The Commissioner disallowed the capital gain and contended they were sold in the ordinary course of business. That is our next issue, whether these are capital gains as distinguished from ordinary income.

Our next issue is the matter of the depreciation of these automobiles. The taxpayer had over a long period of time reported these cars as having a useful life of four years. We will show that this depreciation basis had been approved by the Bureau on previous examinations and nothing had occurred to change the basis, and that neither the holding time of the cars nor the selling price were predictable items as the cars were purchased. The holding time and selling price for the two years in question are not constant, they are something that [8] may be varied or applied to others, and that during these two years that there were no different situa-

tions than there had previously been, where the property was depreciated over a period of a four-year life.

* * *

OPENING STATEMENT ON BEHALF OF THE RESPONDENT

By Mr. Welch: [9]

* * *

Of course, that gets back to the big point in the case and that is the question of the useful life and salvage value of the automobiles. In that case we have a taxpayer who maintains a fleet of somewhere between one hundred fifty and two hundred fifty automobiles and they are constantly being replaced. And the evidence will show that, the income tax returns have a detailed schedule and they will be offered. They show the dates of acquisition and dates of sale and various other information with respect to the cars. Now, respondent's determination in this case is that those automobiles had a useful life of seventeen months and that is based on a forty-year experience of the taxpayer in this particular activity, and at the end of that seventeen-month period respondent's determination is that the automobiles had a salvage value of \$1,325 per car. Now, the allowable depreciation has been computed with those two factors in mind and the adjustments to the depreciation claimed on the return are rather substantial. In 1950, a sum of fifty-six thousand dollars plus has been disallowed as being excessive [11] depreciation, and in 1951, the sum of

sixty-two thousand plus has been disallowed as excessive. That is really the big point in this case. That is the difference between the taxpayer claiming a four-year life on his automobiles with no salvage value and respondent's determination that the cars have a useful life of seventeen months in this business, this business being the leasing and rental of automobiles, and the fact will show as to whether the cars have no longer life than that.

The Court: You mean customers want a new car every time they go to rent one?

Mr. Welch: That is correct and it is understood in this business. That is the case.

Now, in making that determination we have made substantial adjustments in the amount of gain or profit realized when these cars were sold, but in making this adjustment there still is remaining in the deficiency notice a small profit that was produced when the cars were sold and we have treated that as ordinary income, so our position is somewhat in the alternative because we have adjusted the useful life and we have adjusted the depreciation and in taking that action we have cut down the amount of gain or profit considerably. Now, if the court should adopt some other useful life or some other salvage value, then, that would affect the basis and require some recomputations as to the residual amount which would be considered neither as capital gain or ordinary income, depending on how [12] the court will decide that question. And it will be shown that there were a large number of sales in each year. There were over a hundred and

forty sold in 1950 and 147 in 1951, and those sales constitute quite a volume. There is enough turnover, respondent feels, to constitute a business.

The Court: A separate business, from the business of renting the cars?

Mr. Welch: Yes.

The Court: It could be considered all one business and it was the natural course of things that these cars had to be disposed of because they were no longer useful in the rental business.

Mr. Welch: If that be the case, your Honor, that would virtually, in my opinion, fix the useful life, because they are no longer useful in the business.

The Court: You mean this is a case where you can't lose?

Mr. Welch: Well, I don't say I can't lose and I don't like to express this completely in the alternative.

The Court: I am surprised there haven't been cases in this field before that we have decided, but I can't put my finger on any right now.

Mr. Welch: I only know of one, and the depreciation question wasn't raised. The other question was raised there.

The Court: Maybe these automobile dealers where they [13] have floor cars might have some bearing on it.

Mr. Welch: Rather than to express it completely in the alternative, respondent's position as shown in the statutory notice is that there are really two activities going on, and my point is that if the useful life and salvage value is fixed by finding,

then there will have to be some recomputation with respect to the profit gained and derived from the sale because the basis is going to have to be adjusted.

The Court: And we will have to determine what the nature of the profit is.

Mr. Welch: That is all I have at this time. [14]

* * *

Mr. Iversen: I will recall Mr. Evans.

I might state to the Court that that concludes the first phase of the matter. Now we will take up another phase.

ROBLEY H. EVANS

recalled as a witness for and on behalf of the Petitioner, having been previously sworn, was examined and testified further as follows:

Direct Examination

By Mr. Iversen:

Q. You are the same Mr. Evans that was on the stand [63] previously? A. Yes.

Q. Mr. Evans, what is your business and occupation?

A. Leasing and renting automobiles.

Q. Was that your business in 1950 and '51?

A. Yes, sir.

Q. How long have you been in that business?

A. I have been in the business under my own ownership since 1936, and prior to that from 1924 to 1936, I worked for others in the same business in various capacities.

(Testimony of Robley H. Evans.)

Q. Will you describe what that business is, what was it in 1950 and '51? Give us a general description?

A. It was the business of leasing automobiles under a contract to a corporation.

Q. Well, can you give us a general description of what your setup was there in 1950 and '51? What you did and what the corporation did?

A. I leased the cars to the corporation because the corporation did not have sufficient funds.

Q. What was the name of the corporation?

A. Evans-U-Drive, Incorporated.

Q. When was that formed?

A. That was formed, I think, in 1949.

Q. On what basis did you lease the cars to them?

A. At the outset they were leased at the rate of \$45.00 [64] per month per car for the smaller vehicles and the corporation did all the maintenance work on the cars, I was not involved in that. And they were to be returned to me at the end of their period in good condition, reasonable wear and tear accepted.

Q. Was there any agreement between you and the corporation?

A. Yes, sir, there was.

Mr. Iversen: Again I am going to offer these and I would like to substitute photostatic copies, I have the originals here. If there is no objection on that score, I will ask the Clerk to please mark these three documents.

(Testimony of Robley H. Evans.)

The Clerk: Petitioner's Exhibit No. 9 marked for identification.

(Petitioner's Exhibit No. 9 was marked for identification.)

Q. (By Mr. Iversen): I hand you what has been marked as Petitioner's Exhibit No. 9 for identification, which you will note contains three documents stapled together. Will you state what is contained in Petitioner's Exhibit 9, what those are?

A. It is a series of agreements between myself and the Evans-U-Drive Corporation. There is an original agreement and several supplemental agreements.

Q. When was the original agreement entered into? [65]

A. July 15, 1949.

Q. And the first supplemental one, when was that entered into?

A. First day of August, 1949.

Q. When was the second supplemental?

A. First day of December, 1951.

Q. Are these the documents under which the leasing arrangements were carried out?

A. Yes.

Mr. Iversen: I offer Petitioner's Exhibit 9.

Mr. Welch: There will be no objection.

The Court: I understand there is no objection so they will be admitted.

(Petitioner's Exhibit No. 9 was received in evidence.)

(Testimony of Robley H. Evans.)

Q. (By Mr. Iversen): What did the business of Evans-U-Drive consist of?

A. The corporation engaged in the business of leasing vehicles to customers for long periods of time, usually from 18 to 36 months, that was the leasing phase of the business. The other phase of the business was the renting of cars to the general public on what we term a transit or short-term basis. That might be for a few hours or a few days or several weeks.

Q. Now, the stipulation covers the stock ownership in the business, who actually was the manager of it? [66]

A. I acted as manager.

Q. During 1950 and '51, did you have income from sources other than your car leasing business?

A. In 1950 I had some farm income. Then, I had income as manager for the corporation.

Q. Substantially how much of your time was taken up with the leasing and rental business?

A. Practically all of my business hours.

Q. Now, with respect to the automobiles that were used in this business, what caused you to acquire cars?

A. Cars were acquired to meet the demands of the business itself, that is, of the leasing and renting business. These demands would fluctuate from time to time, depending on seasonal influences, but the cars were purchased strictly for the use of the rental and leasing business.

Q. Did you acquire any cars for the purpose of sale?

A. No, sir.

(Testimony of Robley H. Evans.)

Q. What were the considerations that would cause you to dispose of cars?

A. That was necessitated by the realization of a surplus of cars due to several reasons. The primary reason, I think, would be the rapid decline of business on and after Labor Day. We enjoyed a seasonal tourist business here, but we had cars we could not use after Labor Day. Also there was the return of leased vehicles due to the cancellation of the particular [67] lease or the renewal of a lease which required new automobiles and the old ones, of course, returned. And these cars also created a surplus which we found necessary to dispose of.

Q. With respect to this Labor Day date that you speak of, what happened in regard to disposing of cars? I believe you have indicated that is when your lease time came.

A. Yes.

Q. Did you dispose of them immediately or did you hold them for market?

A. No, we sold them as soon thereafter as possible. We had a problem with that. We had storage and we were faced with the problem of storing and paying rent and there was no point in holding them until next spring, so we sold them as rapidly as they were available or surplus in our fleet.

Q. With reference to the state of the wholesale market, did you hold cars when they became surplus?

A. No, we paid practically little or no attention to the wholesale market; we were unable to; we didn't think it was good business and it was

(Testimony of Robley H. Evans.)

burdensome to gear out disposing of cars to any wholesale market or any other market.

Q. When you had a surplus on hand, how did you select the particular cars that you would dispose of?

A. Well, of necessity, we like to keep our rental fleet in as good condition as possible so as a rule I would survey the cars and select perhaps at first those that had been [68]damaged or the upholstery had been burnt or torn or otherwise soiled and we would usually dispose of those cars first.

Q. Just what was the means by which you disposed of the cars? How did you go about it?

A. The cars were sold mainly to used car dealers or jobbers or brokers, people who dealt in automobiles.

Q. Did you do any advertising of your cars for sale?

A. No, we did not. We did no advertising of any sort.

Q. Did you have any retail sales facilities such as used car lots or anything like that?

A. Never had any used car lot or sales agency under my own name or any other or associated with anybody in such endeavor.

Q. Did you employ salesmen? A. No, sir.

Q. Were you ever listed in the telephone book or any classified advertising as a dealer in automobiles?

A. No, sir, not for the years in question or any other years.

(Testimony of Robley H. Evans.)

Q. How did the people who were interested in cars get in touch with you about purchasing them?

A. Oh, I would say that it was general knowledge among used car dealers that we would occasionally have cars for sale. I think that they would know that there would be cars available at times and they would approach me to see if we had any to [69] dispose of at the time they were interested in acquiring cars.

Q. Did you have to go out and seek out your purchasers?

A. No, they all came to me, it wasn't necessary.

Q. Did you have a ready market for your surplus cars?

A. Pretty much, it wasn't difficult to move them in wholesale channels.

Q. With respect to the number of cars sold at a time, what was the situation generally?

A. Oh, we would sell anywheres from maybe just one car to perhaps eight or ten to a particular dealer.

Q. Was it customary to sell cars singly to people?

A. It wasn't customary, but we did do it.

Q. Generally about what were the prices with respect to the market that you sold your cars at during these years?

Mr. Welch: I object to that. I think that that matter has been stipulated, and, moreover, the tax returns are in evidence.

Mr. Iversen: I don't think there is anything stipulated on that.

(Testimony of Robley H. Evans.)

The Court: No particular price, it is just the relationship of the price he was selling at and the general market price.

Mr. Welch: If he has knowledge which of course is the matter—

Mr. Iversen (interrupting): Let's see if he [70] can.

The Court: You may answer if you know.

A. I got the best wholesale price I could get for each vehicle at the time it was disposed of and that price was something, of course, under the going retail price. I think roughly, as a rule, it was about two hundred dollars less than the retail price for a particular vehicle.

The Court: You made no attempt to get the retail price?

The Witness: No, sir.

Q. (By Mr. Iversen): Why didn't you sell to retail customers?

A. Oh, there were several reasons. First of all, I am not much of a salesman and I think successful selling of cars requires a certain amount of natural horse-trading ability, which I don't possess. I was fearful that anything I might enter into in selling cars I couldn't handle. And then, again, we couldn't sell cars from our own place of business because there is a general misapprehension amongst the public at large that you-drive cars are not good automobiles to buy. If we sold them from our own place we would have that sales resistance, so I would have

(Testimony of Robley H. Evans.)

had established a lot outside to sell these cars. I felt perhaps it would also become known that these were you-drive cars and we would not be able to get the full retail price for them.

Mr. Iversen: On this issue now you may examine. [71]

Cross-Examination

By Mr. Welch:

Q. Mr. Evans, you have used an expression "wholesale." Now, by wholesale you mean a transaction to a person who is a dealer in cars?

A. Generally speaking, yes, sir.

Q. That would be a used car dealer?

A. Or broker or anyone engaged in the used car business.

Q. Well now, could you name perhaps one or two of the dealers with whom you have regular dealings?

A. Oh, yes, Verhey Motor Company of Everett, Washington; Kerr Motor Company; a man by the name of Myers of Everett, Washington. I could name a lot of them.

Q. You are able to sell cars from time to time to these various dealers whom you mentioned?

A. Yes, sir.

Q. And others?

A. Yes, sir.

Q. Do you contact them personally or is that done through someone else?

A. They come into the office or the garage. This is a situation that has grown up from several years.

(Testimony of Robley H. Evans.)

Q. Do you make a regular announcement or something of the sort that you have certain cars that you are retiring from your fleet or something of the sort? [72]

A. No, sir, I don't.

Q. They just drop around from time to time and see what you have?

A. Yes, that is correct.

Q. You say it is your policy to retire the oldest cars, that is, you make a decision as to which cars you are going to take out?

A. That is correct, yes, sir.

Q. Do you ever sell a current model car in good condition?

A. I have not sold a current model car in good condition. I have on occasion purchased a new car for a friend on an accommodation sale but I have never sold them other than that.

Q. I hand you your 1950 and 1951 tax returns, Respondent's Exhibit B and C and ask you to refer to the attached schedules here which describe the sales of one entitled long-term loss schedule, of short-term gain schedule, of long-term capital gains of 1950. Now, the schedule of short-term gains here shows on five or six sales of cars that were held less than six months, is that the accommodation sale type of thing?

A. I would have to refresh my memory.

Two of these cars were purchased by the corporation, because, I think, they had been damaged

(Testimony of Robley H. Evans.)

beyond repair and the other two, I think, are perhaps accommodation sales.

Q. Did the corporation have some cars during 1950 and [73] '51?

A. Yes, they were able to acquire a few cars.

Q. It didn't have a quantity of cars that you had individually?

A. That is correct. I think one of these cars was badly wrecked and sold for junk.

Q. What make car is usually handled, who is the manufacturer?

A. They will run in the order of Chevrolet, Ford and then Plymouth.

Q. And you buy these from local dealers as new cars? A. Yes.

Q. You don't buy directly from the factory?

A. May I qualify that statement, please?

Q. Yes.

A. We buy from the dealer, but the dealer is, in turn, reimbursed by the factory for the cars he sells to us. He is reimbursed on an allotment basis.

Q. You purchase at a price that is not retail?

A. That is correct.

Q. Say, factory price?

A. That is right, the factory backs up the dealer.

Q. Who makes the delivery of these cars to you?

A. The dealer.

Q. And you take delivery in Seattle? [74]

A. In most cases we have taken delivery outside of the area for leased cars that are used in other areas, but mostly in Seattle.

(Testimony of Robley H. Evans.)

Q. Is there an individual lease on each car to the corporation or are they all covered in the one agreement?

A. They are all covered in one agreement.

Q. There would be no problem of selling the car, if the occasion arose to sell it, so far as having to cancel the lease or anything of that sort, as between you and the corporation?

A. I don't think I understand you.

Q. No problem arises in that respect, you are free to sell a car at any time as the owner, despite this agreement you have with the corporation?

A. Oh, I think that is true, I was free to sell the car if I wished, but good tactics would dictate that I wouldn't enter into that program.

Q. After Labor Day, as a seasonal matter, you say that you had a surplus of cars on hand, is that the time when you did most of your selling or disposing, as you perhaps want to refer to it?


A. After Labor Day until such time as the new cars become available.

Q. Now, the new models would normally come out about what time of the year? [75]

A. In '50 and '51 they were not announced until around January, but they actually didn't become available until maybe February or the first of March. Of course, we didn't need many at the time, but we did start buying about that time.

Q. The cars that are sold to these used car dealers are, what is their general condition at the time

MICRO CARD

TRADE MARK 

22



5

9



181

(Testimony of Robley H. Evans.)

they are sold, their physical condition and state of repair?

A. As a general proposition, they are in pretty fair shape. There are the exceptions which I think we try to dispose of earlier, the cars with upholstery damaged or otherwise not desirable, we got rid of those first. By and large they were in pretty good shape.

Q. About how much mileage would they have?

A. That would depend on whether it was a transit vehicle or a leased vehicle. If a transit, I would guess the mileage 15,000 to 20,000, if a leased vehicle, the mileage might run up to 50,000.

Q. And the car itself would have an age of somewhere between 12 and 24 months at that time?

A. The taxable year we are talking about now?

Q. I am talking about the length of time you owned it.

A. In the taxable years they would be anywhere from 12 to 36 months old.

Q. Most of the cars were current models that you kept, were they not? [76]

A. I must back up on that just a little bit. At the beginning of the year we probably had most of the last year's models, that is, in '50 we probably had mostly '49 cars, and then during the year of '50 that would be gradually changed so we would wind up at the end of the year with mostly 1950 model cars on hand. There, again, you have to qualify the difference between the lease and transit phase. In

(Testimony of Robley H. Evans.)

the lease phase it would probably be current at the end of 1950, but in the lease phase we would be operating cars from '48 or '49.

Q. Isn't it considered good business in the car rental business to have a fresh stock of current models?

A. Most definitely it is, it is brought about by competitive, competition brought about by customer demand.

Q. There is considerable local competition?

A. Yes, there is.

Mr. Welch: No further questions on this issue at this time. I am assuming that we are only covering the question of whether any of these cars are held for sale.

Mr. Iversen: Yes, the capital gain issue.

Redirect Examination

By Mr. Iversen:

Q. About what per cent of your cars went to this Mr. Verhey that you named during the years in question?

A. Mr. Verhey was a very good customer and I think we perhaps in these years disposed of roughly around three hundred [77] cars.

Q. What do you mean by accommodation sales?

A. During those years cars were not necessarily plentiful and sometimes could not get the particular kind of model that they wanted and they would ask me to intercede for them and secure a car for them, which I was able to do.

(Testimony of Robley H. Evans.)

Q. Did you make any profit on that business?

A. No. I generally marked the car up about ten or fifteen or twenty dollars to take care of my book-keeping expenses.

Q. Was that open to the public?

A. No, sir.

Mr. Iversen: That is all I have on this issue.

I am going to call another witness. Would Your Honor let me call him after lunch so I don't have to split that.

The Court: I intended to recess for lunch until 2 o'clock.

Mr. Iversen: You may step down, Mr. Evans. You are excused.

(Witness excused.)

The Court: We will recess until 2 o'clock.

(Whereupon, a recess was taken until 2 o'clock p.m.)

Afternoon Session

The Court: We will continue with the matter at hand.

Mr. Iversen: If the Court please, I now have the photostats of the copies of the returns for 1946 and '47. [78] Inasmuch as the original returns are not present, I would like to offer the taxpayer's copies. It will be noted that these are not signed, they are simply the taxpayer's copies and I am offering them as secondary evidence, but they are true copies.

Mr. Welch: Respondent has no objection, your Honor.

The Clerk: Petitioner's Exhibits Nos. 10 and 11 marked for identification.

The Court: They will be admitted.

(Petitioner's Exhibits Nos. 10 and 11 were received in evidence and marked for identification.)

Mr. Iversen: Mr. Verhey, will you take the stand, please?

Whereupon,

BERNARD VERHEY

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please.

The Witness: Bernard Verhey.

Direct Examination

By Mr. Iversen:

Q. Where do you live, Mr. Verhey?

A. Everett, Washington.

Q. What is your business?

A. I operate an automobile agency. [79]

Q. What is the name of the agency?

A. Verhey Motor Company.

Q. Were you in that business in 1950 and '51?

A. Yes, I have been there since 1935.

Q. What do you do in your business?

(Testimony of Bernard Verhey.)

A. I buy and sell automobiles.

Q. Was that your business in 1950 and '51?

A. Yes, sir.

Q. Were they new or used cars?

A. Used cars.

Q. How long have you been engaged in the business of dealing with used cars?

A. Since 1935.

Q. During 1950 and '51, did you purchase any cars from Mr. Robley H. Evans? A. Yes.

Q. About how many cars did you purchase from him at that time?

A. I would say, in the neighborhood of a hundred.

Q. And what sort of prices, I am not asking for figures on it, but what sort of prices did you pay for them with respect to wholesale, retail, or their relationship to the market?

A. We have a book that we follow. There is a wholesale and retail on the book and if the car is in average or above average condition we pay low book for it. [80]

Q. Is that book a retail or a wholesale price?

A. It is a wholesale price, sir.

Q. With respect to the cars that you bought from Mr. Evans in 1950 and '51, were they in good operating condition?

A. Yes, I found his cars to be in very fine shape.

Q. About how many miles of operation would you say generally those cars had on them when you would buy them?

(Testimony of Bernard Verhey.)

A. As I recall, it was between nine and ten thousand miles on the average car at that time.

Q. How did you happen to go to Mr. Evans for cars?

A. Back in 1947 I used to buy a lot of cars from a car dealer by the name of Atteberry at Sixth and Lanory, and at times he wasn't able to supply me so at one time I asked him where I might buy some and he suggested that I go over to Fifth Avenue and talk to Mr. Evans. And I believe that was back in 1948, either '47 or '48 that I started buying cars from Mr. Evans. At that time he was located on Fifth Avenue. I don't know the exact address.

Q. What kind of an establishment did you find there when you went to Evans?

A. He was renting cars at the time. It was a U-Drive place.

Q. Had you ever seen any advertising or solicitation with respect to his selling cars?

A. No, I hadn't. [81]

Q. When you went there either that time or any other time had there been any solicitation to you by him of the business of selling cars? A. No.

Q. Did you at any time, either then or subsequently, ever see any advertising of used cars for sale by Mr. Evans?

A. I never noticed any, no, sir.

Q. When you went to him with respect to cars as you have related, what occurred?

A. Well, I drove the cars and I told Mr. Evans

(Testimony of Bernard Verhey.)

what I would pay and, as I recall, I bought a couple that day. And later I went back and since then I have been buying ever since from him.

Q. How do you know when to contact him?

A. I do most of my buying here in Seattle and he, as I understand it, he buys these cars about \$50 off dealers' cost, possibly a hundred, and there is no new car dealer that can compete with the price that he sells them to us at. That is why I have gone back to him.

Q. Do you know whether or not other dealers go to him in the same way that you do?

A. I at one time had a brother and brother-in-law that operated a car lot at Sunnyside, Washington, and I told them about buying through him and I know they have purchased some cars through him. I have told Ernie Rutger at Bellingham and [82] Lynndale about buying there.

Q. Has Mr. Evans ever paid you anything for referring dealers to him?

A. No, sir.

Q. How are the prices arrived at that the cars are sold to you for?

A. As I told you before, we go by a book, it is called the N.A.D.A. book. If a car is in good condition we pay low book for them. This book is issued every thirty days.

Q. In the purchase of these cars, did you inspect them yourself?

A. Yes, I do all of my own buying.

Q. Did the inspection that you made of the car have anything to do with what you paid for it?

(Testimony of Bernard Verhey.)

A. Yes; certainly it would have. If it had bent fenders or poor tires, why, we would pay less than book for it.

Mr. Iversen: That is all. You may examine.

Cross-Examination

By Mr. Welch:

Q. Mr. Verhey, do you have a regular agreement or understanding with Mr. Evans to take any specified number of his cars? A. No, I don't.

Q. You stated that you bought perhaps a hundred during 1950 and 1951? [83] A. Yes.

Q. Has that continued at about that rate since that time?

A. Well, I think possibly I have bought more than that in the last couple of years.

Q. About how many cars would you sell in your used car business?

A. We average between sixty and seventy cars a month retail.

Q. That would be about seven hundred fifty cars a year that you sell? A. That is right.

Q. So you are getting some quantity of your inventory from Mr. Evans?

A. However, we buy in the East too, we buy different places and we buy right off the lot. We don't get our whole supply from Mr. Evans.

Q. Do you buy cars from other auto rental people?

A. I have purchased cars from the T. B. Corbett people, I think it is called Northwest Rent-A-Car.

(Testimony of Bernard Verhey.)

He is located where Mr. Evans used to be. There is another firm out in Ballard that I buy some from. The manager of that is Hal Huskinson.

Q. So a considerable portion of the cars that you sell are obtained from out-to-lease and out-to-rental people?

A. Perhaps fifty per cent of them, I would say, yes.

Q. Is that commonly known that you are a dealer in cars [84] that have previously been rental cars?

A. If they ask me I tell them.

Q. But you don't publicize that?

A. No, I don't.

Q. And there is no way that a purchaser can find that out without asking you?

A. We don't certainly, try to hide it from them that they are leased cars.

Q. In your dealings with Mr. Evans, you normally work with him personally, don't you?

A. I have until the last three or four years, then I have dealt with a man by the name of E. E. Richert.

Mr. Welch: I have no further questions of this witness.

Mr. Iversen: That is all I have.

May this witness be excused?

Mr. Welch: Yes.

(Witness excused.)

Mr. Iversen: That concludes this issue and I will recall Mr. Evans.

Whereupon,

ROBLEY H. EVANS

recalled as a witness for and on behalf of the Petitioner, having been previously sworn, was examined and testified further as follows: [85]

Direct Examination

By Mr. Iversen:

Q. For the purpose of the record, you are the same Mr. Evans that has been on the stand before?

A. Yes, sir.

Q. Now, during 1950 and '51, to whom did you lease your cars?

A. Evans-U-Drive, Incorporated.

Q. And those were all the cars that you had out on a lease?

A. Yes, sir.

Q. Are you familiar with the business of Evans-U-Drive during those years?

A. I was, I was the manager for them.

Q. What did Evans-U-Drive do with their cars?

A. We leased the cars to long-term lessors and we rented them to the transit customers on short-term rentals.

Q. Will you describe a typical leasing and a typical rental arrangement?

A. A leasing agreement is one wherein an automobile is leased to a, or automobiles are leased to a corporation or a company and sometimes individuals, for a period of time, usually from 18 to 36 months. The Evans-U-Drive furnished the car and

(Testimony of Robley H. Evans.)

maintained it but did not supply the gasoline or oil or insurance on that vehicle. [86]

On the transit rental operation, that is simply a transaction where a car is rented for an hour or two or possibly a week and that car was returned and there was a rate charged for that time and mileage, for that service.

Q. When you have the car on a leasing arrangement as you have described, at the termination of that lease, what did you customarily do with the car? A. At the termination of the lease?

Q. Yes.

A. At the termination the car became surplus and we disposed of it.

Q. Did you put it back into your rental fleet?

A. No.

The Court: You couldn't re-lease it?

The Witness: Not likely. The car was two or three years old at the time, it was more desirable to give the customer a new car if he renewed his lease, or if a new customer, give him a new car.

Q. (By Mr. Iversen): During that period what would be the occasion for you to buy new cars? What would cause you to buy new cars?

A. There again there are two separate factors, two separate requirements. In the lease phase of the business the cars would be purchased to supply a new lease customer with vehicles or on the renewal of the lease customers we would supply them [87] with new vehicles at the termination of the lease period. In the transit phase of the business it was

(Testimony of Robley H. Evans.)

dictated by seasonal requirements. Our seasonal business was very abrupt. We perhaps did two and a half times as much business in August as we would in the month of February, for instance.

The Court: Let me interrupt a minute.

On this leasing business, how did you make money? You buy a car, a new car, and lease it for a couple of years and at the end of that period it is not worth a re-lease, you say, because you have to furnish another new car. Do you make your money off the lease or the rentals or do you figure in what you are going to get for that car, the salvage value?

The Witness: We get our money off the lease. The lease rate had to stand on its own feet. We could not depend upon the sale of the vehicle. First of all, we had no way of looking forward a period of 18, 24, or 36 months to determine what that car may be worth, so the lease rate had to be self-sufficient and support the use of the vehicle.

The Court: How about the person who rents a car from you, wouldn't it be cheaper for him to buy a car and use his own?

The Witness: Not necessarily, because we enjoy, as a rule, better buying privileges. We get in with the automobile and together with all the supplies and repairs that go into that car, we could usually do it cheaper than the lease customer [88] could do it.

The Court: I am ignorant of this sort of thing.

The Witness: We have rented cars or leased

(Testimony of Robley H. Evans.)

cars to B. F. Goodrich Company. I think we started in about 1946, and certainly there is a company that is large enough to maintain their own fleets and have accounting departments to determine if it is economical enough.

Q. (By Mr. Iversen): What sort of things caused you to dispose of cars?

A. The creation of a surplus by reason of our seasonal decline in the transit business and the return of the leased automobile.

Q. What effect would such things as the condition of the cars have on your disposition of the cars?

A. I don't understand the question there.

Q. The state of repair, the economic cost and so forth of the cars, does that have any bearing?

A. As to the disposal?

Q. Yes, as to repair cost and that sort of thing.

A. I said earlier we would usually select, we would have a surplus of cars and we would select those cars that needed repairs or had been damaged or had bad upholstery or otherwise not desirable as rental vehicles and dispose of those first.

Q. What effect does the salvagability of cars, if any, have upon your policies in regard to your determination to dispose of cars? [89]

A. That is always a factor whether or not cars are available. Particularly in '50, '51 and prior years there were strike conditions and manufacturing conditions such that the manufacturers could not guaran-

(Testimony of Robley H. Evans.)

tee a delivery date to us, we could not sell ours as shortly, it was a factor in our disposal.

Q. What sort of records ~~do~~ you keep in 1950 and '51 on your cars?

A. There was a car inventory sheet and each vehicle was set up on its own basis, giving the make, serial, motor number, the type of vehicle, from whom it was purchased, the date and that same record sheet contained its cost and rate of depreciation.

Mr. Iversen: Would you mark this, please?

The Clerk: Petitioner's Exhibit No. 12 marked for identification.

(Petitioner's Exhibit No. 12 was marked for identification.)

Q. (By Mr. Iversen): I hand you what has been marked Petitioner's Exhibit 12 for identification and ask you to state what that is.

A. This is a typical car equipment record that we keep on the automobiles.

Q. What is the nature of the information that it shows?

A. It contains the year, make, body style, motor number, serial number, date of purchase, date of disposal and rate of [90] depreciation.

Q. Is that kept as to particular cars or the fleet in general?

A. Each one of these are kept for each automobile.

Mr. Iversen: I offer Petitioner's Exhibit No. 12 as a typical record.

(Testimony of Robley H. Evans.)

Mr. Welch: Mr. Evans, does this Petitioner's Exhibit 12 for identification show the actual sales price of the car?

The Court: You mean the sales price after it has been sold by Mr. Evans?

Mr. Welch: Yes.

The Witness: This record washes out this sheet. The actual sales price of the vehicle is recorded on our day ledger. This last item is a journal entry to wash out the vehicle from the total. At that time it was kept in another ledger but it is available.

Mr. Welch: This is the purchase price here?

The Witness: The total is here. That is the vehicle plus whatever equipment. In this case there was a radio installed.

Mr. Welch: And do you know, in the lower left-hand corner there is a series of figures by months?

The Witness: That is the depreciation by the month of that particular car based on a life of four years.

Mr. Welch: With no salvage value? [91]

The Witness: Yes, sir, that is right.

Mr. Welch: There will be no objection to this exhibit.

The Court: It will be admitted.

(Petitioner's Exhibit No. 12 was received in evidence.)

Q. (By Mr. Iversen): That figure of \$45.00 per month that the cars are leased to Evans-U-Drive came about in what manner?

(Testimony of Robley H. Evans.)

A. That was based on a one forty-eighth of the cost of the vehicle. That is depreciating it on a 25 per cent basis plus the cost of the license, plus some profit.

Q. Did the state of competition in Seattle in 1950 and '51 have any bearing on your decision as to when you would sell cars?

A. It was a factor. We had to keep a reasonably modern fleet. If our competitors had had certain types or makes of vehicle we felt that we should follow along.

Q. What effect would such things as the development of new accessories such as automatic gear shifts and things of that kind have?

A. That would be the same thing. If we had standard shifts and our competitors had the automatic shifts, we would feel to maintain our customers we would have to supply the same type of automobile.

Q. About 1950 and '51, did that have any bearing? [92]

A. Automatic shifts were just coming into general use.

Q. During 1950 and '51, could you have continued using these cars in your business for a longer time than you did?

A. From an economic and operation standpoint yes, we could, we have used them for longer periods before.

Q. How long have you used cars in your business?

(Testimony of Robley H. Evans.)

A. We have used cars as long as, in some cases, 72 months. That is unusually long, but we have done so.

Q. What is the longest period that you recollect?

A. I think 76 months is the longest we have ever used an automobile.

Q. In each of the taxable years '46 through '53, what was the longest period you held cars?

A. I will have to quote from this memorandum from our official record: in '46, 27 months; '47, 76 months; '48, 24 months; 1949, 32 months; 1950, 36 months; 1951, 24 months; 1952, 32 months; and 1953, 46 months.

Q. From your experience can you say about how long a time a car used in commercial business might continue to be useable as an automobile with reasonable economic usefulness?

A. That is a very broad question and one I think that one could get in trouble with, a little bit perhaps, but I am sure it is my experience that an automobile in commercial usage is certainly good for about four years.

Q. Now, you have indicated some cars go beyond that? [93]

A. It is entirely possible. If we are talking about an average from my personal experience, it would set it at four years. There may be types of work they could be used longer in or less.

Q. From your experience is it possible to determine at the time you purchase a car what the sale price is going to be on it when you sell it?

A. I think that is utterly impossible for many

(Testimony of Robley H. Evans.)

reasons. First, I do not know when I am going to be able to sell that automobile; second, technical advances are made in the building of automobiles from the time you buy one to the time you get ready to sell it or dispose of it that will affect the value. There are other factors almost too numerable to mention, the Korean War was one. In 1950, the price of used cars went up abnormally because of the war, everybody was anticipating shortage. No one knew when the war was going to end and rationing was anticipated, which ballooned the values of used cars beyond their normal value, I think. Those are a few of the factors. I don't know how many you want, but there are so many variables I don't see how anyone could foresee the sales price of a car in 12 or 18 or even 6 months ahead.

Q. Now, you have referred to factors that might vary the holding time of the cars. Are there other factors beyond such things as the Korean War or contingencies of that time that would vary the holding time? [94]

A. In the lease business it depends upon the duration of the lease. Naturally, we have to retain the car that is leased for the period that it is contracted for. There are also some questions of supply that is ever present. I think that is all I can think of at the moment.

Mr. Iversen: Mr. Clerk, I am looking for that bunch of tax returns.

Q. (By Mr. Iversen): Mr. Evans, I have here various tax returns covering the years 1946 through

(Testimony of Robley H. Evans.)

1954, inclusive. Can you state from examination of these tax returns or from your knowledge of what is in them, the basis upon which you took depreciation for those cars over the period covered by those returns?

A. We have always used the depreciation rate of 25 per cent a year, even for these taxable years here, and as far back as 1936, the rate has always been 25 per cent.

Q. What about the year 1947?

A. We used the same rate of depreciation; 25 per cent a year.

Q. Was there an adjustment for the year 1947?

A. An adjustment? I don't believe I understand that question.

Q. After you had made your return for the year 1947, was the return questioned by the Bureau of Internal Revenue? A. Yes, it was. [95]

Q. And was there an adjustment made as a result of the questions raised by the Bureau of Internal Revenue?

Mr. Welch: Objection, your Honor. That is a matter which involves the taxable year not before the court and counsel refers merely to an adjustment by the Bureau of Internal Revenue, not a matter which was adjusted in court or by an agreement. It is not competent, it isn't proper evidence in this proceeding.

Mr. Ivesen: If the Court please, I think we have a right to put this in because we are trying to establish a reasonable method of depreciation, an

(Testimony of Robley H. Evans.)

interpretation by the Department themselves of their own regulations consistent with the Department's own policies as to the meaning of the terms "depreciation" and "useful life," and I think we have a right to establish the view that the Department themselves officially took as to the meaning of those terms and the manner of their application to this taxpayer's business at a time prior to his making the returns for the questioned years.

We propose to show that the Department concurred in the determination or in the depreciation taken by the taxpayer on a four-year basis during 1947, just before he made out his returns for these years, that he made his return upon the basis of an approved method.

The Court: When you say the Department concurred, do you have a ruling of a [96] Commissioner?

Mr. Iversen: We have not a ruling of the Commissioner, but we have an adjustment letter from the Internal Revenue Agent in charge.

Now, the taxpayer, of course, has to make, he is a self-assessment business, he is supposed to make his return available, too, without hindsight. We are taking terms that are not defined by statute or regulation, depreciation and useful life, and the taxpayer is now following the approved method. It has been agreed upon by the representatives of the Commissioner in making the returns of these years.

The Court: Maybe he is getting an advantage that he wasn't entitled to.

(Testimony of Robley H. Evans.)

Mr. Iversen: I think we have a right to show the administrative interpretation of these terms and the meaning that is given to these terms "useful life" and "depreciation."

The Court: Do these depreciation adjustments apply to the same cars that are in issue here?

Mr. Iversen: The same kind.

The Court: Not the same ones?

Mr. Iversen: Not the identical vehicles, but the cars used in the same manner, sold in the same manner and the same business. Our issue here is whether or not the taxpayer is permitted to take depreciation on a 25-per cent basis, and we propose to show that the interpretation of the taxpayer and that of the representatives of the Commissioner concurred [97] at that time in the depreciation method that was established.

The Court: This witness himself has testified that there are a lot of mechanical changes in cars from year to year and there may be lots of things in these cars that are under consideration here that weren't included or built into the cars at that time. This is '47 you are talking about?

Mr. Iversen: '47; we are talking about a matter of principle; a method of taking depreciation. We propose to show that the government approved the method of taking depreciation.

The Court: Do you have anything further to say, Mr. Welch?

Mr. Welch: Only this, your Honor, that the de-

(Testimony of Robley H. Evans.)

iciency notice before the Court, speaks for itself and the year 1947 is beyond reach, you might say, of the Respondent, by deficiency notice or otherwise. And the matter that he refers to is merely an action by the Internal Revenue Agent in charge and has no official, doesn't constitute an official action as far as being binding on the Commissioner for future years.

Mr. Iversen: We have a further point. The Revenue Rulings 90 and 91, 1953, provide that a depreciation method established will not be disturbed in the absence of a change in method or change in circumstances. This is important in the application of those revenue rulings, shows we have an established method of showing depreciation. [98]

The Court: Objection is overruled.

Q. (By Mr. Iversen): Mr. Evans, what, if any, question was raised with respect to your 1947 income tax return, particularly relating to depreciation, by the Bureau of Internal Revenue?

A. The Bureau questioned the depreciation and the absence of the salvage value in 1947 returns.

Q. What did the government contend at that time?

A. They said there should be a five hundred dollar per car salvage on each vehicle.

Q. Did you protest that? A. Yes, sir.

Q. What happened as a result of that protest?

A. As a result of the protest, the government approved of the depreciation rate of 25 per cent per year and established a salvage value of one hundred fifty dollars per car which I accepted

(Testimony of Robley H. Evans.)

because there were other items involved, and we came to that agreement.

Q. To what stage or what level was this matter considered? With whom was the matter considered, so far as the federal government?

A. It was discussed with the Conferee, Mr. Diamant.

The Clerk: Petitioner's Exhibit No. 13 marked for identification.

(Petitioner's Exhibit No. 13 was [99] marked for identification.)

Q. (By Mr. Iversen): I hand you what has been marked Petitioner's Exhibit No. 13 for identification and ask you to state what that is.

A. This is a letter from the Treasury Department to me approving of the settlement on the basis I gave you, 25 per cent depreciation and a hundred fifty dollar salvage basis.

The Court: Is that the basis upon which you claim 25 per cent a year under the years here? How about the salvage value? I understood you didn't admit any salvage value.

The Witness: In the year '50 and '51, I did not use salvage value, because I did not concur with the government findings relative to salvage value.

The Court: I think I am going to rule this out, because you can't come in and try to bind the Commissioner on something that has been done when you haven't complied to what he did.

Mr. Iversen: The government did approve a four-year depreciation basis. The taxpayer did not

(Testimony of Robley H. Evans.)

concur in the salvage value, but insofar as it was a four-year depreciation basis, that is entirely different from the present contention of the government that there is only an eighteen-month depreciation basis. It goes to the fundamentals of the case, the fundamental differences as of 1947, they were depreciating on the basis of the useful life of the article itself, now they are [100] depreciating on the basis of the time that the taxpayer holds the article. That is the difference. In one case it is the article and in the other case it is the business of the taxpayer.

The Court: I think they are both sufficiently different so we have a new proposition here and I don't see what the Commissioner did back in 1947, in which the taxpayer himself has not acquiesced, I don't think it is relevant. You haven't offered it yet.

Mr. Iversen: I am going to offer it and I offer it knowing that it shows an approval of a useful life based upon the life of the asset itself over a four-year basis as distinguished from the holding time of the taxpayer.

The Court: I will make my own ruling without any objection. I will say that it is irrelevant and rule it out.

Mr. Iversen: I would like to make an offer of proof that this document, if admitted, will show that the Conferee approved a depreciation of the cars over a period of four years with a salvage value of which, in effect, raises only an issue between the taxpayer and the government of the question of the length of its useful life, and that this depreciation

(Testimony of Robley H. Evans.)

basis that was set by this letter was a fundamentally different procedure of applying depreciation.

The Court: What you are saying now is argumentative, Mr. Iversen. [101]

Mr. Iversen: I offer this document which will show a depreciation based upon the useful life of the article as distinguished from the holding period of the article by the taxpayer.

The Court: But it does show also that there was a salvage value fixed.

Mr. Iversen: I think it should be before the Court.

The Court: You made your offer, it is there.

Mr. Iversen: Does your Honor keep rejected documents?

The Court: I think it should be in the record as offered and rejected but with an offer of proof.

(Petitioner's Exhibit No. 13 was rejected.)

Mr. Iversen: You may examine.

Cross-Examination

By Mr. Welch:

Q. Mr. Evans, I want to first ask you about the repairs that you make on these cars. Do you run a complete repair shop in connection with your business to maintain them?

A. A mechanical shop but not a body shop.

Q. If you had a transmission problem or something of the sort, would you sell the car or would you—

(Testimony of Robley H. Evans.)

A. (Interrupting): We would repair the transmission.

Q. Do you normally overhaul your motors or do the cars [102] reach that age?

A. Oh, we only overhaul motors when they become damaged in some manner, by lack of oil or water.

Q. Mr. Verhey, who is here from Everett, testified that many of the cars that he obtained from you had eight to ten thousand miles on them. Would those be cars that were rented on a day-to-day basis that had that mileage?

A. First, I might say, he might have been a little off on the mileage, but those were rented on a day-to-day basis, yes.

Q. What portion of the cars did you have on a day-to-day basis as compared to those on leases?

A. Oh, I think I would say that in those years we had about 30 or 40 per cent on lease and the balance on transit rental.

Q. Now, the transit rental type are turned over more quickly, are they not?

A. That is correct, yes, sir.

Q. Would you estimate that during 1950 and '51 they lasted from 12 to 15 months or thereabouts and were then ready for replacement?

A. I think 15 to 16 months would be perhaps nearer the case, without any reference to records.

Q. And the customer demand dictated that to some extent?

A. Yes. [103].

(Testimony of Robley H. Evans.)

Q. The renting public on a day-to-day basis wants something current with low mileage?

A. Current, if they can get it.

Q. For the day-to-day rental type of car, the car would have a reasonably short life in your business?

A. I would say 14, 16 months.

Q. Maybe it isn't worn out at that time, but so far as your business is concerned that car is ready to be put in the used car lot?

A. The economical life of the car has not been consumed, but certainly its attractiveness to the customer has been limited after it is 16 months old or so.

Q. On these cars that are under lease, you mentioned B. F. Goodrich Company, how long would you lease a car, for what length of time would a lease to them run on a car?

A. Eighteen months in some instances and twenty-four months in other instances.

Q. And the other leases would average that length of time?

A. From eighteen to thirty-six months, yes.

Q. You stated on your direct examination a maximum period for each of the years mentioned from 1946 through 1954. Now, those were maximums, were they not?

A. They were; that is what I was asked.

Q. That is well above the average time that the cars [104] were used in your business?

A. That is correct, yes.

Q. As a practical matter, at what point, mile-

(Testimony of Robley H. Evans.)

Q. Now, would you say your cars reach an uneconomical stage of repair, you might say? If you had a car 12, 15 months and it has twelve or fifteen thousand miles on it, is that car—assuming it looked like a current model—is that car in such shape that you retain it? A. It could be.

Q. But these cars do reach a point where the repairs make them rather uneconomical to keep, that is, if you have to keep them in the shop half of the time?

A. There is a point beyond which it is not economical to run an automobile.

Q. So when you reach a point of fifteen to twenty thousand miles with the kind of driving that these cars might get, just depending on customer carelessness and this and that and the other, you reached a point where you have to make a sort of decision?

A. Not as far as the economic use of that vehicle is concerned, only insofar as the style and modernness is concerned, because we can run cars longer than eighteen or twenty thousand miles.

The Court: Time is probably more important than mileage in your business. [105]

The Witness: That is correct, sir.

Q. (By Mr. Welch): Do you often replace tires on a car? A. Quite frequently, yes.

Q. What about batteries?

A. They are very seldom changed.

The Court: What kind do you use?

The Witness: Batteries are good for about two years with us.

(Testimony of Robley H. Evans.)

The Court: I am sorry to interrupt.

Q. (By Mr. Welch): I want to go back again to this one point. This seasonal decline in rental cars, that comes up at about Labor Day, you say?

A. Roughly after Labor Day, in the month of September.

Q. That wouldn't have any effect on your leased cars? A. No, sir.

Q. The current models come out later in the year, that is, in such quantity as you are able to get them?

A. In the years of '50 and '51, they did not introduce the current model cars until January of that year. Now they are introduced in October, but then they were introduced in January.

Mr. Welch: I have no further questions.

Redirect Examination [106]

By Mr. Iversen:

Q. Counsel asked you about repair facilities, are those conducted by you or the corporation?

A. They are conducted by the corporation.

Q. The question was asked as to whether rental cars last as long as other cars. I think your answer was not clear. Could you answer that question again?

A. What was the question?

Q. I believe you were asked by counsel whether the cars on rental last as long as the leased cars. What would you say with respect to that?

A. We did not keep them as long as the leased

(Testimony of Robley H. Evans.)

cars. The transit rental cars were not retained as long as the leased cars by reason of the fashion or mode, whatever you want to call it, but as far as lasting as long, they would have lasted as long if we had not the competitive model change factors.

Mr. Iversen: That is all.

The Court: The witness may be excused.

(Witness excused.)

Mr. Iversen: Mr. Johnson, will you take the stand, please?

Whereupon,

PAUL F. JOHNSON

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows: [107]

The Clerk: State your name, please.

The Witness: Paul F. Johnson.

Direct Examination

By Mr. Iversen:

Q. What is your business, Mr. Johnson?

A. I am a certified public accountant and I am in the firm of Ernst and Ernst.

Q. How long have you been in that business?

A. I have been with the firm of Ernst and Ernst since July of 1930.

Q. Have you been in the accounting business longer than that?

(Testimony of Paul F. Johnson.)

A. No, sir; I started there a month after I graduated from college.

Q. What is your education?

A. I graduated from the University of Illinois in 1930, with a major in accounting.

Q. Are you licensed as a C.P.A. in the State of Illinois? A. Yes, sir.

Q. Will you give us a brief description of your accounting experience?

A. I joined our firm in July of 1930 as a junior accountant working on the audit staff. I progressed to senior accountant and then to assistant manager. I gradually moved into tax work and I have been primarily in tax work since 1942. [108]

Q. Are you authorized to represent taxpayers before the Internal Revenue Department?

A. Yes, sir.

Q. Have you had any experience representing taxpayers before the Internal Revenue Department in depreciation matters prior to 1954?

A. Yes, sir, I have.

Q. What is your understanding from a general accounting point of view of the meaning of the term "useful life"?

A. As I have seen useful life applied in the setting of depreciation rates, the term means to me the economic or the physical life of a particular asset.

Q. Now, the Internal Revenue Code of 1939 provided for depreciation in terms of a reasonable allowance for exhaustion and wear and tear and a

(Testimony of Paul F. Johnson.)

reasonable allowance for obsolescence of property subject to depreciation. Now, in your experience in dealing with the representatives of the Internal Revenue Service and applying this specific provision of the statute, has any meaning been attached for federal income tax purposes different from the accepted accounting meaning of the term "useful life"?

A. No; I think they have been the same.

Q. From the general accounting point of view, what is the meaning of the term "salvage value"?

A. Well, I think in defining salvage value, you have [109] get back first and link it to useful life. With the definition I gave of useful life, of the physical or economic life of the particular asset, then I think you come to the point of the salvage value being the junk or scrap value of the asset, and that is, normally, of course, negligible in the overall evaluation.

Q. In the present case I call your attention to the fact that the Internal Revenue Service is contending that the use of an automobile for federal income tax purposes, for depreciation purposes, during 1950 and '51, is equal to the actual period during which the taxpayer held his automobile, that is, an average of 17 months. And I call your attention also to the fact that the Internal Revenue Service has also taken the position that salvage value of the taxpayer's automobiles during these years is equivalent to his average sales proceeds. Do you consider this to be a change from the practice of the Internal

(Testimony of Paul F. Johnson.)

Revenue Service during the period 1950, '51 and years prior thereto?

A. Yes, it—

Mr. Welch (Interrupting): I object, your Honor. I move that the answer be stricken. I think the question is designed, first, to have this witness take over the function of the Court.

The Court: That is what all experts do, isn't it?

Mr. Welch: He is asked to state an opinion as to [110] Internal Revenue practice. Now, what Internal Revenue practices, perhaps you will find it here and there in regulations and rulings, but it certainly isn't controlling here.

The Court: I know that, but I am going to let it in with the same idea that I know it is not controlling. I am not going to let it control me.

Mr. Iversen: You may examine.

Cross-Examination

By Mr. Welch:

Q. Mr. Johnson, would you include within your definition of "useful life," when you describe it as the economic or physical life of the property, would you include it to mean the economic or physical life in the taxpayer's business?

A. Well, perhaps I can understand your question. Let me try to answer it.

Q. I think that it is merely a question asking you to accept or reject a definition. Does the qualification, "life in the taxpayer's business" have any

(Testimony of Paul F. Johnson.)

thing to do with the definition, or is the life that anyone might have to do with it?

A. I think that the physical or economic life of the asset is the period for which it will be useful to someone. It is quite possible that a specific taxpayer may subject an asset to more strenuous use which would make the physical life in his business possibly shorter than it would be in someone else's business. [111]

Q. You don't put any weight on that in defining the useful life of an asset, you don't give any weight to the particular way it is employed or the business in which it is employed?

A. If I said that, I didn't intend to convey that, sir. My feeling is that useful life means the period for which it will be useful to someone and if the particular taxpayer subjects it to strenuous use it will be shorter than it would be in the hands of someone who subjects it to less strenuous use.

Q. You defined salvage value as the junk value and you defined it as being something negligible?

A. Yes, sir.

Q. You are not willing to extend the definition to include the value at which the property can reasonably be disposed of when it ceases to be useful to the taxpayer?

A. That has not been the practice that I have seen, sir. In other words, the salvage value in my understanding is what it is worth after the useful life has been exhausted as far as everybody is concerned.

Mr. Welch: No further questions of this witness.

The Court: The witness may be excused.

(Witness excused.)

Mr. Iversen: Mr. Hoffman, would you take the stand, please?

Whereupon,

RAYMOND A. HOFFMAN

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name, please.

The Witness: Raymond A. Hoffman.

Direct Examination

By Mr. Iversen:

Q. What is your business, Mr. Hoffman?

A. I am a certified public accountant.

Q. What connections, if any, do you have?

A. I am a partner in the firm of Price-Waterhouse and Company.

Q. Where did you receive your accounting education?

A. I was graduated from the University of Illinois and received a Bachelor of Science from the College of Commerce, and also have a Master.

Q. What states do you have a license of C.P.A.?

A. Illinois and quite a number of others.

Q. Will you give a brief description of your accounting experience?

(Testimony of Raymond A. Hoffman.)

A. I have been in public accounting since 1934, and for the approximately last twenty years my activities have been devoted primarily to federal income tax work.

Q. Are you authorized to represent taxpayers before the Internal Revenue Service?

A. Yes, sir. [113]

Q. Have you experience representing taxpayers before the Internal Revenue Service in depreciation matters prior to 1954?

A. Yes, sir.

Q. What is your understanding from a general accounting point of view of the meaning of the term "useful life"?

A. The term "useful life" as it has been used in general accounting for the purpose of determining depreciation rates is used to denote the physical life or economical life for the purpose for which a particular asset was intended by the manufacturer.

Q. Now, in your experience with dealing with representatives of the Internal Revenue Service and applying the provisions of the Internal Revenue Act of 1939 with respect to exhaustion, wear and tear, including a reasonable allowance for obsolescence subject to depreciation, has any other meaning been attached to the term "useful life"?

A. No, sir, the same meaning has been attached to that phrase.

Q. From the general accounting point of view, what is the meaning of the term "salvage value"?

A. That is generally looked upon as synonymous with junk value, at the end of its useful life.

(Testimony of Raymond A. Hoffman.)

Q. In this case the Internal Revenue Service is contending that useful life for automobiles in 1950 and '51 is equal to actual period during which the taxpayer held the automobiles, [114] an average of 17 months and the Internal Revenue Service has taken the position that the salvage value during this period is equivalent to the average proceeds. Do you consider this to be a change of practice from the years prior to the years 1950, '51?

A. It is, from the general interpretation of the terms that have been used for federal income tax purposes.

Cross-Examination

By Mr. Welch:

Q. Mr. Hoffman, in defining salvage value, is it possible to look upon an asset having served its useful life in a particular business and having either reached the point of salvage value or something else that would be obsolescence or the fact that the thing is completely outdated and has to be taken out of that particular business, would you consider that the term salvage value would embrace an asset that might become obsolete before it wears out?

A. No. Normally the phrase salvage value you would not apply to the resale value of an item as it might be purchased to be used by somebody else before the expiration of its useful life.

Q. It is possible, isn't it, then, to have a useful life in a business which is shorter than the—I am

(Testimony of Raymond A. Hoffman.)

speaking now of in a business in which it is much shorter than the actual length of time it would take to wear that asset out, whether it be a [115] watch or an automobile or anything else, a particular business may expect to find that the property becomes obsolete before it is worn out, then, wouldn't you define useful life as being the actual anticipated life of that asset in that business?

A. No. You are bringing in the subject of obsolescence which would make it no longer economically useful in something other than it was intended. If you are talking about the useful life with respect to a particular taxpayer, then, you are using the expression in a different sense than it has been commonly used for depreciation purposes, and that was the point I was trying to make.

Q. The Commissioner's regulation uses the expression "useful life in the taxpayer's business," do they not?

A. I have no recollection of that exact phraseology in the regulation, no, sir.

Q. You wouldn't know whether that phraseology would be contained in Bulletin F?

A. No, I would not be able to say whether or not it is actually there as such. I don't believe you will find that term defined in the bulletin. I can't speak to that. The phrase may be used, but I don't think you will find that phrase defined in Bulletin F.

Mr. Welch: I have no further questions.

The Court: The witness may be excused.

(Witness excused.) [116]

Mr. Iversen: We rest.

Mr. Welch: Respondent rests, your Honor.

The Court: How much of this case do you want me to decide right now?

Mr. Iversen: We assume that your Honor will want briefs.

The Court: Well, I think I can dispense with briefs on the first point, that is, whether or not this taxpayer was in the business, of selling real estate or was holding this land for sale in the ordinary course of his business. I don't think the Respondent will have to brief that. I will decide that point in the favor of the taxpayer.

The other questions are more difficult and I would like them briefed and I would like proposed statements of findings of fact.

Will forty-five days be enough or do you want sixty days, Mr. Welch?

Mr. Welch: I would rather have sixty days.

The Court: I think simultaneous briefs in this type of case. You won't have to brief that first portion. I will expect the Petitioner to supply me with adequate findings of fact.

Mr. Iversen: That will come in at the time of the final decision or will your Honor wish the findings on that portion of it now? [117]

The Court: It will come right in with the regular briefs.

Mr. Welch: A Rule 50 will be necessary for that first one.

The Court: I just want to save you the time for briefing that part of it. Of course, you will have to brief the residence portion. I am not deciding that, as to how much to be allowed on that residential conversion or whatever you call it.

Mr. Iversen: Briefs will be simultaneous briefs and they will be due sixty days from today?

The Court: That is correct, and twenty days to reply if you want to file reply briefs.

The Clerk: Those dates, gentlemen, April 8, and the reply brief is April 29.

The Court: We will recess.

(Thereupon, at 3:30 o'clock p.m., Tuesday, February 5, 1957, the hearing was closed.)

Filed: February 26, 1957, T.C.U.S. [118]

[Title of Tax Court and Cause.]

PETITION FOR REVIEW OF DECISION OF TAX COURT

Taxpayers Robert H. Evans and Julia M. Evans, the petitioners in this cause, by their attorneys, Roswell Magill, Lyle L. Iversen and Donald J. Yellon, hereby file their petition for a review by the United States Court of Appeals for the Ninth Circuit of the decision entered by the Tax Court of the United States on February 7, 1958, determining a deficiency

in petitioners' federal income taxes for the calendar years 1950 and 1951 in the respective amounts of \$13,191.52 and \$13,048.12 and respectfully show:

I.

The petitioners are husband and wife. During the taxable years here involved, they resided at Bellevue, in the County of King, State of Washington, and filed their income tax returns for each of the years here involved with the Collector of Internal Revenue for the District of Washington.

The place where the petitioners resided at the time of the filing of the aforementioned returns, and the place where the office of said Collector (now Director) of Internal Revenue is located, are within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, and said Court has jurisdiction of a review of the decision of the Tax Court herein under the provisions of Section 7482 of the Internal Revenue Code of 1954.

The decision of the Tax Court herein was rendered on February 7, 1958. The time for filing a Petition for Review will expire on May 6, 1958, under Sections 7459(c) and 7483 of the Internal Revenue Code of 1954.

II.

Nature of the Controversy

The controversy involves the proper determination of the petitioners' federal income taxes for the calendar years 1950 and 1951.

At issue is the correct method of computing deductible depreciation, under Section 23(1) of the Internal Revenue Code of 1939, on automobiles used by Robley H. Evans (hereinafter, the word "petitioner", refers to Robley H. Evans) in his business of leasing and renting automobiles. The amount in controversy involves a deficiency of \$23,139.12 out of a total deficiency of \$26,239.64. The petitioners do not contest the remaining deficiency of \$3,100.52, which is not based upon the controversy concerning deductible depreciation.

The petitioner, in accordance with the established meanings of "useful life" and "salvage value," computed depreciation on his automobiles on the straight-line method, employing a useful life of 4 years, without residual or salvage value and without regard to the length of the period he himself continued to own such automobiles. The petitioner applied the term "useful life" of property, for depreciation purposes, as meaning the physical or inherent functional life of that property. He applied the term "salvage value" of property, for depreciation purposes, as meaning the residual, junk or scrap value of property left after the end of its "useful life," as above defined.

The respondent claimed, and it was the decision of the Tax Court herein, that depreciation on petitioner's automobiles should be computed on the basis of a useful life determined by the period during which the petitioner held particular automobiles as income-producing property in his business, and

that salvage value should be fixed at the amount realized from the disposition of particular automobiles after such holding period) The Tax Court decided that the automobiles leased for relatively extended periods had a useful life of 3 years and a salvage value of \$600, that the automobiles rented for shorter periods had a useful life of 15 months and a salvage value of \$1,375, and that, if any automobile of either class had an "undepreciated cost," on January 1, 1950, less than \$600 or \$1,375, respectively, then such lesser amount was to be taken as the salvage value of such automobile.

III.

The petitioners, being aggrieved by the Findings of Fact and conclusions of law contained in the finding and opinion of the Tax Court and by its decision entered pursuant thereto, desire to obtain a review thereof by the United States Court of Appeals for the Ninth Circuit.

Wherefore, the petitioners pray that a review be had of the decision of the Tax Court rendered in the above-entitled cause and that upon such review said decision be reversed.

Respectfully submitted,

/s/ ROSWELL MAGILL,

/s/ LYLE L. IVERSEN,

/s/ DONALD J. YELLON,

Counsel for Petitioners.

[Title of Tax Court and Cause.]

STATEMENT OF POINTS

Now come petitioners Robley H. Evans and Julia M. Evans, husband and wife (Robley H. Evans being herein sometimes called the "petitioner"), by their attorneys, Roswell Magill, Lyle L. Iversen and Donald J. Yellon, and hereby make this statement of points on which they intend to rely on the review herein:

The Tax Court of the United States erred:

1. In deciding that automobiles leased by petitioner had a useful life, for depreciation purposes, based on the period during which such automobiles were held by petitioner as income-producing properties in his automobile leasing business, and in thereby deciding that:

(a) the useful life, for depreciation purposes, of automobiles leased for relatively extended periods was three years rather than four years, and

(b) the useful life, for depreciation purposes, of automobiles rented for short periods was fifteen months rather than four years.

2. In deciding that automobiles leased by petitioner had a salvage value, for depreciation purposes, based on the proceeds realized by petitioner when he dispensed with such automobiles as income-

producing property in his ~~automobile~~ leasing business and in thereby deciding that:

(a) the salvage value of the automobiles leased for relatively extended periods was \$600 rather than junk or scrap value,

(b) the salvage value of automobiles rented for short periods was \$1,375 rather than junk or scrap value, and

(c) if, on January 1, 1950, any automobiles of either class had an "undepreciated cost" less in amount than \$600 or \$1,375, respectively, such lesser amount was the salvage value of such automobiles rather than junk or scrap value.

3. In holding that there are deficiencies in income tax for the calendar years 1950 and 1951 in the respective amounts of \$13,191.52 and \$13,048.12.

4. In that its opinion and decision are contrary to law and are not supported by substantial evidence.

/s/ ROSWELL MAGILL,

/s/ LYLE L. IVERSEN,

/s/ DONALD J. YELLON,

Counsel for Petitioners.

Received and Filed: March 10, 1958, T.C.U.S.

[Title of Tax Court and Cause.]

CERTIFICATE

I, Ralph A. Starnes, Chief Deputy Clerk of the Tax Court of the United States, do hereby certify that the foregoing documents, 1 to 11, inclusive, constitute and are all of the original papers on file in my office as called for by the "Designation of Contents of Record on Review" (but excluding the exhibits which are separately certified) on file in my office as the original and complete record in the case before the Tax Court of the United States docketed at the above number and in which the petitioners in the Tax Court have filed a petition for review as above numbered and entitled, together with a true copy of the docket entries in said Tax Court case, as the same appear in the official docket in my office.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 20th day of March, 1958.

/s/ RALPH A. STARNES,

Chief Deputy Clerk, Tax
Court of the United States.

[Endorsed]: No. 15985. United States Court of Appeals for the Ninth Circuit, Robley H. Evans and Julia M. Evans, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of the Tax Court of the United States.

Filed: April 7, 1958.

Docketed: April 17, 1958.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

101 Minute entry of argument and submission—October 15, 1958 (omitted in printing).

102 In the United States Court of Appeals for the Ninth Circuit

Before POPE, HAMLEY and JERTBERG, Circuit Judges

Minute entry of order directing filing of opinion and filing and recording of judgment

January 26, 1959

Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the Clerk; and that a Judgment be filed and recorded in the minutes of the Court in accordance with the opinion rendered.

103 In United States Court of Appeals for the Ninth Circuit

No. 15985

ROBLEY H. EVANS AND JULIA M. EVANS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

UPON PETITION TO REVIEW DECISION OF THE TAX COURT OF THE UNITED STATES

Opinion

Jan. 26, 1959

Before: POPE, HAMLEY and JERTBERG, Circuit Judges.

JERTBERG, Circuit Judge:

The main issue presented to this Court on the petition for review of the decision of the Tax Court of the United States centers on the rate of depreciation to which the taxpayers are entitled on automobiles used by them in their business of leasing automobiles to a corporation which was engaged in the business of leasing and renting automobiles to the public.

The Tax Court entered its decision finding deficiencies in income tax due from taxpayers for the years 1950 and 1951 in the respective amounts of \$13,191.52 and \$13,048.12.

There appears to be no dispute between the parties as to the character of the taxpayers' business or the manner in which it was conducted during the years in question.

During the years 1950 and 1951 Robley H. Evans and Julia M. Evans¹ were husband and wife. During these years Robley H. Evans (hereinafter designated as petitioner) was engaged in the business of leasing automobiles to Evans U-Drive, Inc. (hereinafter called U-Drive) at a monthly rental of \$45.00 per month per automobile. U-Drive was engaged in the business of leasing and renting automobiles to the public, which business was managed by the petitioner.

The lease agreement between petitioner and U-Drive provided that petitioner was obligated to furnish U-Drive with a sufficient number of automobiles to enable it to conduct and operate an automobile leasing and renting business in an efficient manner.

During the taxable years under review U-Drive engaged in two types of rental activities, which for convenience might be termed short term rentals and extended rentals. Short term rentals varied from a few hours to several weeks. Extended rentals varied from eighteen months to thirty-six months, and accounted for thirty to forty per cent of automobile rentals.

Under the lease agreement with U-Drive, petitioner retained title to the automobiles, and had the right to sell and dispose of any of them at any time.

Petitioner periodically owned more automobiles than were necessary for the efficient operation of short term rentals. When this situation arose he would examine the cars in use and sell the number which were not needed. The oldest and least desirable cars were sold first. When sold, such cars had been driven an average of 15,000 to 20,000 miles, and were generally in good mechanical condition. Many automobiles were sold at the end of the tourist season. When sold, each car had been in use about fifteen months. These cars could have been used longer than they were, but customers of U-Drive demanded late model cars that were currently in style.

Automobiles to be used for extended rentals were purchased by petitioner when needed and leased to others by U-Drive. At the termination or cancellation of such leases, the automobiles were returned to petitioner, who sold them. When sold,

¹ Julia M. Evans is a party solely because of the filing of joint returns for the taxable years involved.

such cars had been driven an average of 50,000 miles. They were generally in good physical condition and state of repair at the time of disposition, and petitioner could have continued to use them longer than he did.

Petitioner sold most of his surplus automobiles to used car dealers, jobbers, or brokers, and as a general rule the automobiles when sold brought current wholesale prices.

Petitioner purchased new cars from local dealers, usually at factory prices.

Petitioners' tax returns for 1950 and 1951 revealed that he sold 140 and 147 automobiles respectively during those years. The average cost, sales price, depreciation claimed, and gain per car were approximately as follows:

Year	Cost	Sales price	Depreciation claimed	Gain
1950	\$1,650	\$1,380	315	245
1951	1,495	1,395	450	350

In such tax returns the amounts of depreciation taken were computed and deductions claimed on the basis that the automobiles had an estimated useful life of four years, with no salvage at the end of the four-year period.

The Tax Court determined:

1. That the automobiles which petitioner leased to U-Drive during the taxable years for use under extended rentals had a useful life of three years and a salvage value of \$600.00;

2. That the automobiles which he leased to U-Drive for use under short term rentals had a useful life of fifteen months and a salvage value of \$1,375.00;

3. If the undepreciated [adjusted] cost of the automobiles in service at January 1, 1950 is less than \$600.00 and \$1,375.00 for the respective classes of automobiles, then that amount will be the salvage value of those automobiles.

Computations based upon such decision resulted in the amounts of deficiency above mentioned for the years under review.

In the notice of deficiency directed to petitioner, the Commissioner stated that "It has been determined that the average useful life of the automobiles used in your business based on your actual experience was not in excess of seventeen months.

and the average *salvage value* of said automobiles at the end of their useful life in your business was not less than \$1,325.00 or the adjusted basis of said automobiles as of January-1, 1950, whichever amount was the lesser." [Emphasis added.]

The Tax Court found that "The surplus automobiles sold by Robley (Evans) could have been used longer than they were; however, customers demanded late model automobiles that were currently in style. Older automobiles did not have much value as rental vehicles. During the taxable years, Robley (Evans) sold the automobiles used by U-Drive in the short-term rental phase of its business after they had been used about 15 months. And he usually sold the automobiles which had been leased for extended terms as soon as the lease was terminated." The Tax Court further found that 30 to 40 per cent of the automobiles leased by petitioner to U-Drive were on the extended rental basis, which period was from 18 months to 36 months, and that as a general rule the automobiles were sold at current wholesale prices. In its opinion the Tax Court stated that petitioner had consistently claimed deductions for depreciation (apparently since 1936) on the basis that his automobiles had a useful life of four years, with no salvage value at the end of the four-year period.

It is the petitioner's position on this review that until the opinion of the Tax Court herein, judicial interpretation, administrative practice under the 1939 Code, and practice in the accounting profession generally, had long agreed that, for the purpose of the depreciation deduction, the term "useful life" means the physical, economic or functional life of the property subject to the depreciation allowance, and the term "salvage value"—the value remaining in depreciable property at the end of its physical, economic or functional life—means its residual or scrap value.

Analysis of the findings of fact, conclusions of law, and decision of the Tax Court unmistakably reflect that the Tax Court measured "useful life" by the holding period of the automobiles leased by petitioner to U-Drive and measured "salvage value" by the estimated proceeds which might be realized upon the disposition of such automobiles.

The Tax Court's opinion contains no discussion as to the legal signification of the terms "useful life" and "salvage value". The concepts of such terms and the contentions in relation thereto as advanced by the petitioner were not mentioned.

The question presented by this review is a narrow one, although not without its difficulties. In most instances, an asset used in the trade or business remains in the service of the taxpayer until its economic usefulness has been exhausted. Under such circumstances, no problem arises as to the useful life of the asset,

and the value remaining in the asset at the end of such useful life—its salvage value—is generally its scrap or junk value. The problem is acute with respect to tax-

107 payers, the nature of whose business requires, for various reasons, a policy of disposing of depreciable assets while such assets still possess substantial value, and which property brings on disposal prices considerably in excess of the scrap or junk value. Such a business is the type in which petitioner engages.

It is our view that the issue presented by the conflicting concepts of "useful life" and "salvage value" involve principally taxpayers engaged in such type of business whose tax years under the Internal Revenue Code of 1939 are open for review and assessment by the Commissioner. This issue may also involve taxpayers engaged in such type of business whose tax years prior to the enactment of Section 167 of the Internal Revenue Code of 1954 and the issuance of Treasury Regulations T.D. 6182 are likewise open for review and assessment. See *The Hertz Corporation, etc. vs. United States*, U.S. District Court, District of Delaware, (1958), 58-2 U.S.T.C., Paragraph 9720.

In enacting section 167 of the Internal Revenue Code of 1954 (Title 26 U.S.C.A., section 167), Congress authorized several new methods for computing depreciation for taxable years ending after December 31, 1953. Section 167(b) states that a "reasonable allowance" as used in section 167(a) shall include an allowance computed in accordance with regulations prescribed by the Secretary, under any of the prescribed methods and rates. Sections 167(b) and 167(c) prescribe allowable methods and rates for computing depreciation, as well as certain limitations on the use of such methods. The allowable methods are the straight line method, the declining balance method, the sum of the years-digits method, and any other method productive of an annual allowance which does not exceed the allowance computed under the declining balance method. If an allowance is reasonable under section 167(a), it shall not be limited or reduced by any provision contained in section 167(b). Section 167(c) restricts the accelerated

method contained in section 167(b) to new construction and to new tangible property with a useful life of three years or more.

Regulations under the Internal Revenue Code of 1954 were issued June 7, 1956, T.D. 6182, 1956—1 Cum. Bul. The depreciation provisions of these regulations relevant to this discussion are set forth in section 1.167(a)-1. Section 1.167(a)-1-(a) states that the allowance [reasonable allowance under section 167(a) of the Code] is "that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan [not necessarily at a uniform rate], so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property. * * * An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. * * * The allowance shall not reflect amounts representing a mere reduction in market value."

Section 1.167(a)-1-(b) states "For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. * * *"

Section 1.167(a)-1-(c) states, "Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. * * * If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. * * *"

Finally, for the guidance of taxpayers, there are now official definitions of the terms "useful life" and "salvage value", and definite rules for their application.

There can be no dispute over the fact that the Tax Court applied to the facts of this case definitions of "useful life" and "salvage value" which appeared for the first time in Regulations T.D. 6182, promulgated under the 1954 Code. The Commissioner does not seriously argue otherwise. His position appears to be that the concepts of "useful life" and "salvage value" embodied in the new regulations have been applied under all

Revenue Acts and regulations since 1918, including the Internal Revenue Code of 1939, and regulations issued thereunder.

The petitioner vigorously disputes such position.

109 We will now proceed to explore the validity of the petitioner's contention that until the opinion of the Tax Court herein, judicial interpretation, administrative practice under the 1939 Code, and practice in the accounting profession, had long agreed that, for the purpose of the depreciation deduction, the term "useful life" means the physical or economic life of the property subject to the depreciation allowance, and that the term "salvage value"—the value remaining in depreciable property at the end of its physical or economic life—means its residual or scrap value.

The basic statute on depreciation in the Internal Revenue Code of 1939 is section 23. This section in its relevant part provides: "Sec. 23. Deductions from gross income—In computing net income there shall be allowed as deductions . . . k. Depreciation—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(1) of property used in the trade or business, or (2) . . ."

This basic provision relating to depreciation of property used in a trade or business has been a part of every Internal Revenue Act since 1918.² This same basic provision appears in the Internal Revenue Code of 1954.³

In none of the depreciation provisions contained in revenue acts from the Revenue Act of 1918 has Congress seen fit to define the term "reasonable" in providing for a "reasonable allowance" for exhaustion, wear and tear. This basic provision is so general as to render an interpretative regulation appropriate. *Morrissey, et al., Trustee vs. Commissioner of Internal Revenue*, 296 U.S. 344; *Helvering, Commissioner of Internal Revenue vs. R. J. Reynolds Tobacco Co.*, 306 U.S. 110.

Treasury Regulations 111 (1942) were promulgated under the Internal Revenue Code of 1939, and are applicable to the years 1950 and 1951, which are the taxable years under review. The relevant portions of Regulations 111 are contained in section 29.23(1). Pertinent extracts from such section are: " . . . The proper allowance for such depreciation is that

² Sec. 234(a)-1 and Sec. 241(a)-8 of the Revenue Act of 1918, c. 18, 14 Stat. 1057.

³ Sec. 167, Title 26 U.S.C.A.

amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis * * * Section 29.23(1)-1.

"The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. * * * Section 29.23(1)-4.

"The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, * * * The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. * * * Section 29.23(1)-5.

The first appearance of the terms "useful life" and "salvage value" in Treasury Regulations was in Treasury Regulations 45, Article 161 (1919), effective for the calendar years 1918-19 and 1920. Article 161 provided in part, as follows: "The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the *useful life of the property in the business* will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost * * * [Emphasis added.]

Article 165 of the same Regulations provided in part, as follows: "The capital sum to be replaced *should be charged off over the useful life of the property* * * * [Emphasis added.]

Similar wording with changes not material to the problem before us appeared in subsequent Treasury Regulations through Regulations 103, Section 12.23(1)-1-5, effective for the tax years 1939-40 and 1941. The words "in the business" which appeared in Article 161 of Regulations 45 continued to appear in successive regulations until the issuance of Regulations 111 in 1942. No definition or further explanation of the terms

"useful life" or "salvage value" appeared in any of the regulations to which reference has been made until the issuance of Treasury Regulations T.D. 6182, promulgated under the 1954 Revenue Code. The terms "useful life"

and "salvage value" are not defined or explained in Regulations 111. The language of the Regulations does not limit "useful life" to the useful life of the depreciable assets in the business of the taxpayer or to the period during which such assets are held by the taxpayer.

The significance, if any, to be attached to the omission of the words "in the business" from Regulations 111 is obscure. We attach no significance thereto because in our view the practice and position of the Commissioner has been the same under Regulations 45 and succeeding regulations up to T.D. 6182, except for a few recent cases under Regulations 111 of the Internal Revenue Code of 1939,⁴ in which the Commissioner asserted the concepts of "useful life" and "salvage value" embodied in T.D. 6182.

From the practice of the Commissioner over the years, it appears to us that the phrase "in the business" included in earlier regulations simply defined the type of assets which were subject to the depreciation allowance. The omission of such phrase from Treasury Regulations 111 would not furnish the basis for an interpretation of the term "useful life" which it did not have when the phrase appeared in the regulations.

As stated above, the basic statutory provision relating to depreciation of property used in a trade or business was so general as to render an interpretative regulation appropriate. Section 3791 of the Internal Revenue Code of 1939 states that the Commissioner, with the approval of the Secretary, "shall prescribe and publish all needful rules and regulations for the enforcement of this title." Pursuant to such Congressional direction, the Commissioner issued Regulations 111, of which section 29.23(1) is a part. This section was prepared by the department charged with the enforcement of the Act. In carrying out the Congressional directive, it was necessary for the Commissioner to select some base on which the annual allowance for depreciation might be measured. The language in section 29.23(1) indicates that the Commissioner selected as the base the estimated physical or economic life of the depreciable asset, and not the estimated holding

⁴ Koelling vs. United States, U.S. District Court for the District of Nebraska (1957), 57-1 U.S.T.C., Paragraph 9453; Pilot Freight Carriers, Inc. vs. Commissioner (1956), 15 Tax Court Memo 1027; the instant case (1957), 16 GCH, Tax Court Memo 156.

period of such asset in the hands of the taxpayer. The section represents a fairly contemporaneous construction by the Commissioner of the statute. The section is not in conflict with the express provisions of the statute. It is reasonably adapted to the enforcement of the Act. If there exists any doubt as to the construction to be placed on the language of section 29.23(1), such doubt disappears in the light of the consistent practice and position of the Commissioner from 1939 to 1956. No decision of the United States courts or the Tax Court has been called to our attention, except the very recent decisions heretofore mentioned, in which the Commissioner asserted that the term "useful life" should be limited to the period during which the depreciable asset was held by the taxpayer. On the contrary, the consistent, long-continued practice and position of the Commissioner were that "useful life" of the depreciable asset was its estimated physical or economic life.

Our attention has been directed to certain pronouncements of the Commissioner dealing with the general subject under review.⁵ In each of such pronouncements, it is evident that the Commissioner's concept of the term "useful life" was not measured by the period in which the depreciable asset was useful in the taxpayer's business, but was measured rather by the economic or physical life of the depreciable asset.

Further evidence of the position of the Commissioner is drawn from his acquiescence in decisions of the Board of Tax Appeals⁶ which measured "useful life" of the depreciable asset not by the holding period of such asset by the particular taxpayer, but by the economic or physical life of such asset.

In the case of General Securities Co., BTA Memo., CCH Dec. 12,500-D (1942), affirmed per curiam 137 F. 2d 201, the taxpayer claimed a useful life of three years for automobiles used in its business. The taxpayer kept its cars one or
113 two years, and when traded in after one year the cars retained a value of from one-third to one-half of their original value. The Commissioner attempted to compel the taxpayer to depreciate such automobiles over a useful life of more than three years. The Tax Court found that the normal useful life of such automobiles was three years.

⁵ O.D. 845, Cumulative Bulletin—January-June 1921, page 178. I.R. Bulletin 108, 1953-1 CB 185; and Rev. Rul. 54-229, 1954-1 CB 124.

⁶ Sanford Cotton Mills, 14 BTA 1210 (1920), Acq. X-2 CB 63; Merkle Broom Co., 3 BTA 1084 (1926), Acq. V-2 CB 2; Max Kurtz, et al., 8 BTA 679 (1927), Acq. VII-1 CB 18.

In the recent case of Philber Equipment Corp. vs. Commissioner of Internal Revenue, 237 F. 2d 129 (C.A. 3d 1956), taxable years 1951-52 were involved. The taxpayer was engaged in the business of furnishing trucks, trailers and tractors to the public on a lease basis. The single issue in that case was whether the motor vehicles owned by taxpayer were "held primarily for sale to customers in ordinary course of petitioner's trade or business" within the meaning of Sections 117 (a) and (j) of the Internal Revenue Code of 1939, 26 U.S.C.A. section 117 (a) and (j). The court stated at page 130: "During the taxable years, existing conditions made it difficult, or impossible to re-lease most of the equipment. Taxpayer knew that when equipment was purchased, it would probably be able to rent the equipment for a period substantially less than its useful life, and sale of the equipment would follow expiration of a lease." The Commissioner stated in his brief⁷ filed in that case, "Because of existing conditions taxpayer knew when it purchased equipment that it would likely be able to rent such equipment only for a period that was substantially less than its useful life." (Page 5 of brief.) At page 11 of the brief, the Commissioner stated, "* * * all of the leases involved were only for a one-year term, a period substantially less than the useful life of this type of equipment as its resale in the tax years and re-lease in later years demonstrated." The statements of the Commissioner in the above case are simply confirmatory of the position taken by the Commissioner over a period of many years.

Petitioner calls attention to Internal Revenue Bulletin "F", which was issued in 1920 and revised in 1942. It was republished as Internal Revenue Bulletin 173 in 1955. This bulletin sets forth general depreciation policy and tables of estimated lives of particular kinds of assets. This 114 bulletin is titled "Income Tax Depreciation and Obsolescence, Estimated Useful Lives and Depreciation Rates." The title page states, "This bulletin supersedes Bulletin 'F' (revised January 1931) and 'Depreciation Studies' (published January 1931). It contains information and statistical data relating to the determination of deductions for depreciation and obsolescence, from which taxpayers and their counsel may obtain the best available indication of Bureau

⁷ Brief of respondent, Philber Equipment Corp. vs. Commissioner of Internal Revenue, C.A. 3rd, Docket No. 11,860.

practice and the trend and tendency of official opinion in the administration of pertinent provisions of the Internal Revenue Code and corresponding or similar provisions of prior Revenue Acts. It does not have the force and effect of a Treasury Decision and does not commit the Department to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury."

In the first paragraph of the Introduction (Part I, page 1 of the Bulletin) it is stated: "The Federal income tax in general is based upon net income of a specified period designated as the taxable year. The production of net income usually involves the use of capital assets which wear out, become exhausted, or are consumed in such use. The wearing out, exhaustion, or consumption usually is gradual, extending over a period of years. It is ordinarily called depreciation, and the period over which it extends is the normal useful life of the asset."

The first paragraph on page 3, under the heading "Probable Useful Life—Rates of Depreciation and Obsolescence" is as follows: "In general.—The amount of the annual deduction allowable for depreciation is ordinarily dependent upon the expected useful life of the asset. The factors which determine the useful life of property in a trade or business have already been discussed briefly in the Introduction. These factors are wear and tear and decay or decline from natural causes; and also various forms of obsolescence attributable to the normal progress of the art, economic changes, inventions, and inadequacy to the growing needs of the trade or business. Two principal forms or types of obsolescence are generally recognized, that is, normal obsolescence and extraordinary special obsolescence."

At page 7, under the heading of "Salvage" it is stated: "Salvage value is the amount realizable from the sale or
 115 other disposition of items recovered when property has become no longer useful in the taxpayer's business and is demolished, dismantled, or retired from service. * * *

Under the heading "Lives of Depreciable Property" is the following: "In this compilation are listed for each industry the useful lives of various assets, including wherever practicable lives for composite/accounts and group accounts. * * * All lives are given without fractional years. In practice, however, fractions may be used."

The recommended useful life on motors and other vehicles appears on page 52. Therein it is stated, "Motor vehicles included in this classification are those used by commercial enterprises other than public utility and construction.

Lives considered reasonable are indicated below:

Automobiles:	Years
Passenger -----	5
Salesman -----	3 . . . "

In the instant case, as noted above, the petitioner used a useful life of four years in his depreciation schedules.

While we recognize that Bulletin "F" does not have the force of law, we do believe that a fair construction of the pertinent provisions of such Bulletin, aided by the practice of the Commissioner; reasonably indicates that the Commissioner did not consider as a factor in determining depreciation the expected or intended disposal plans of the taxpayer with respect to property used in his trade or business, nor did the Commissioner consider that the useful life of an asset was to be measured by the estimated holding period of such asset by the taxpayer.

Decisions of the Board of Tax Appeals and the Tax Court⁸ extending over many years have, but with little discussion, measured the useful life of a depreciable asset used in the trade or business of the taxpayer not by the holding period of such asset by a particular taxpayer but by the economic or physical life of such asset.

In a recent decision of the United States District Court⁹ involving the same tax years as in the instant case, the same type of business, and the same disposal practice as to automobiles, the court upheld the taxpayer's depreciation practice based on a useful life of three years. Similar holdings were made in district court cases.¹⁰

In *The Hertz Corporation, etc. vs. United States*, *supra*, the litigation arose under the Internal Revenue Code of 1954,

⁸ *West Virginia & Pennsylvania Coal & Coke Co.*, 1 BTA 790 (1925); *J. R. James*, 2 BTA 1071 (1925), Acq. V-1 CB 3; *Wallace G. Kay*, 10 BTA 534 (1928), Acq. VII-1 CB 17; *W. N. Foster, et al.*, 2 TCM 595 (1943); *John A. Maguire Estate, Ltd.*, 17 BTA 394 (1929), Acq. IX-1 CB 34; *Nat Lewis*, 13 TCM 1167 (1954); and *Whitman-Douglas Co.*, 8 BTA 694 (1927).

⁹ *Massey Motors, Inc. vs. United States of America* (U.S. District Court, S.D. Florida 1957), 156 F. Supp. 516.

¹⁰ *Davidson vs. Tomlinson* (U.S. District Court, S.D. Florida, 1958), reported in 58-2 U.S.T.C., Paragraph 9739; *Lynch-Davidson Motors, Inc. vs. Tomlinson* (S.D. Florida, 1958), reported at 58-2, U.S.T.C., Paragraph 9738.

the tax years involved being the years ending March 31, 1954, 1955 and 1956. The district court refused to apply the concept of "useful life" set forth in T.D. 6182 to taxable years prior to the promulgation of such regulations. The court stated: "The final question is whether or not, under the circumstances, the Commissioner may apply these regulations retroactively to include years prior to their promulgation. Retroactive laws are not favored. Long prior to the issuance of the new regulations in 1956, the Commissioner by his pronouncements and conduct had apparently acquiesced in the construction of 'useful life' given to the phrase by business and accounting circles and had been permitting taxpayers to make use of the declining-balance method of depreciation in situations similar to this. Nor did the language of the regulations (prior to that now under consideration) give any indication that the hitherto long-settled interpretation of the term would be changed. Furthermore, when the words 'useful life of the depreciable property' were inserted in the Regulations in 1942, they were capable of the construction that 'useful life' meant the whole physical life of the property.

"Taxpayers had a right to file their returns in reliance upon the Commissioner's long-continued interpretation of his own Regulations. Here a new regulation has been promulgated defining the term 'useful life' pursuant to a statute which for the first time has employed the term and where the intention of Congress with respect to its definition is clearly contrary to the interpretation, as evidenced by conduct and frequent pronouncements, which the Commissioner has given it in the past. Common justice requires that it be given a prospective construction only. * * *"

The long-continued and consistent practice and position of the Commissioner in measuring useful life by the physical or economic life of the depreciable asset were reflected in testimony before the Tax Court. At the trial in the Tax Court, two witnesses testified on behalf of petitioner. Both were certified public accountants licensed to practice their profession in several states, and both were admitted to practice before the Treasury Department. Each was a member of a separate accounting firm which practiced accounting nationwide. Each witness stated that he had had experience representing taxpayers before the Internal Revenue Service on depreciation matters. One witness had practiced his profession since 1930, and

the other since 1934. Both testified that in the accounting profession the term "useful life" for depreciation purposes denoted the physical life or economic life of a particular asset, and that the term "salvage value" denoted the junk or scrap value of an asset at the expiration of its useful life. Both testified that in their experience in dealing with the Internal Revenue Service prior to 1954, on the subject of depreciation, the practice of the Internal Revenue Service was to apply the same concepts of such terms as such concepts were generally understood in the accounting profession. The respondent offered no testimony on the subject. The Tax Court stated, in admitting such evidence, that such testimony was not controlling.

In light of the language of Section 29.23(1), the consistent practice and position of the Commissioner over many years, the interpretation placed on the term "useful life" by decisions of the Tax Court extending over a long period, we hold that under the Internal Revenue Code of 1939 the Tax Court erred when it measured useful life of the depreciable assets involved here by the period during which such assets were held in the business of petitioner instead of the physical or economic life of such assets. The application by the Tax Court of an erroneous concept of "useful life" necessarily requires a re-determination by the Tax Court of "salvage value". The Tax Court determined salvage value to be the estimated proceeds which would be realized from such assets when they were no longer useful in the business of petitioner and were to be disposed of by him, instead of the estimated proceeds which would be realized upon the sale or other disposition of such assets at the end of their physical or economic life. We do not agree with the petitioner's contention that the value remaining in such assets at the end of their physical or economic life necessarily means scrap or junk value. Initially, petitioner should have estimated salvage value upon acquisition of such assets and such value should have been adjusted at the end of each taxable year if conditions then existing reasonably indicated that a different value would probably be realized at the end of the physical or economic life from the sale or other disposition of such assets.

The period over which useful life—meaning the physical or economic life—extends and the salvage value at the end of such period are questions of fact to be determined by the Tax Court on the remand of this cause.

In support of the decision of the Tax Court, the Commissioner argues, inter alia, that obsolescence was the principal factor in the depreciation of petitioner's automobiles, and that the depreciation deduction must be based upon and take into consideration obsolescence as well as exhaustion caused by physical wear and tear. The cogency of such observation is not clear to us unless the Commissioner intends to suggest that petitioner should have but failed to claim depreciation based on obsolescence in addition to claiming depreciation caused by exhaustion through wear and tear. No meaningful mention of the word "obsolescence" appears in the findings, conclusions, decision of the Tax Court, or elsewhere in the record.

Regulations 111 covering the taxable years here in issue provide in section 23.23(1)-6, in part: "With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions *that will result in its being abandoned at a future date prior* 119 *to the end of its normal useful life*, so that depreciation deductions alone are insufficient to return the cost or other basis at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. [Emphasis added.] There is no evidence in the record which suggests that obsolescence is a factor which should be considered in this case. The foundation for obsolescence is, according to the Regulations, the expected early abandonment of the property. The term "abandon" has been held not to include property which was to be sold at a time when it had substantial value and was to be used for other purposes instead of being scrapped. *The Olean Times-Herald Corporation*, 37 BTA 922 (1938); *Southeastern Building Corporation*, 3 TC 381 (1944), affirmed 148 F. 2d 879 (C.A. 5th, 1945), certiorari denied 326 U.S. 740; *Bradley vs. C.I.R.*, 184 F. 2d 860.

The Commissioner also asserts that the decision of the Tax Court must be affirmed because petitioner is not entitled to convert ordinary income into capital gain through the depreciation deduction, and that section 117(j) of the Internal Revenue Code of 1939, which permitted capital gain upon the sale or exchange of certain property used in a trade or business,

must be applied in such a manner that only a "reasonable allowance" for depreciation be deducted.

In his deficiency notice, the Commissioner stated: "It is further held that you were also in the business of selling used automobiles during the years 1950 and 1951. Consequently, the profit realized from the sale of the automobiles was income from the sale of property held primarily for sale in the ordinary course of your business within the meaning of section 117(j) of the Internal Revenue Code and such income may not be treated as a capital gain under the above-mentioned section of the Code. * * * " The Commissioner abandoned that issue in his brief filed with the Tax Court and conceded the right of petitioner, under section 117(j), to treat the sales of his automobiles as sales of property used in his trade or business, not

held primarily for sale to customers in the ordinary course of business. The Commissioner's abandonment of this approach was probably influenced by the decision of *Philber Equipment Corp. vs. Commissioner of Internal Revenue*, supra. That case involved the same type of business in which petitioner engages and with similar disposal practices of automobiles. The court held, since the circumstances disclosed that the acquisition, use and disposition of taxpayer's vehicles was consistent with business purposes of vehicle rental, that his vehicles were not held primarily for sale to customers, and thus the gain from the sale of such vehicles was not ordinary income but was capital gain and was taxable as such.

The argument is not convincing in the light of the long-continued and consistent practice of the Commissioner outlined above, which led taxpayers to adopt a method of depreciation which the Commissioner now contends results in unreasonable deductions for depreciation, and the legislative history of section 117(j). In amending, in 1942, section 117 of the Internal Revenue Code of 1939 by adding sub-section (j), Congress extended to taxpayers who sold at a profit depreciable assets used in a trade or business, held for more than six months, and not held primarily for sale to customers in the ordinary course of business, the favorable treatment on such profits accorded to capital gains. The legislative history of section 117(j) shows that Congress has not receded from its original purpose. Congress was aware of the Commissioner's contention that taxpayers were converting into capital gains

ordinary income arising from unreasonable deductions for depreciation.

Congress and the Treasury Department were well aware of the losses in revenue occurring under section 117(j). The report of the Business Tax Section of the Division of Tax Research of the Treasury Department submitted to the Ways and Means Committee of the House of Representatives (see "Revenue Revisions," 1947-1948; hearings of December 2-12, 1947, Part 5, page 3756) contained warnings against revenue losses through the benefits of capital gain treatment of profits from sale of assets subject to accelerated depreciation, and recommended that if the taxpayer elects to use accelerated depreciation, gains to the extent of the excess of accelerated over

121 normal depreciation should be treated as ordinary income. Congress took no action. In 1950 the Treasury

Department recommended to Congress that losses on the sale of depreciable business assets be treated as capital rather than ordinary losses (see Committee Reports on HR-8920, 81st Congress, Second Session). Again Congress did not act. On April 19, 1954, the Committee on Federal Taxation of the American Institute of Accountants filed with the Senate Finance Committee its recommendation number 180, with respect to section 1231 of the proposed Internal Revenue Code of 1954, as follows: "Gain or loss of property used in the trade or business, etc.; should be treated uniformly as ordinary income or loss."¹¹ The recommendation was heard but not adopted.

In the Revenue Code of 1954, Congress limited capital gains on sales of emergency facilities amortized under section 168, but did not limit capital gains upon the sale of assets used in a trade or business. The House report¹² states, with respect to section 1231, "This section is derived from section 117(j) of the present law. There is no substantive change intended but some rearrangement has been made."

The Commissioner contends that to define "useful life" as the physical or economic life of a depreciable asset does violence of the Congressional intent expressed in the basic statute that there shall be allowed as a deduction from gross income "a reasonable allowance for exhaustion, wear and tear * * * of property used in the trade or business * * *" and is contrary

¹¹ Hearings before the Committee on Finance, U.S. Senate, 83d Congress, Second Session, on HR-8300, Part 3, page 1324.

¹² Page 275 of House Report No. 1337, 83d Congress, Second Session.

to the theory underlying such allowance that the yearly depreciation deduction reasonably reflect that portion of the value of the capital assets consumed in earning the gross income for the taxable year, citing *U.S. vs. Ludey*, 274 U.S. 295; *Virginia Hotel Co. vs. Helvering*, Commissioner of Internal Revenue, 319 U.S. 523; *Detroit Edison Co. vs. Commissioner of Internal Revenue*, 319 U.S. 98.

Again, the Commissioner overlooks the force of his own regulations, his long-continued, consistent practice thereunder, and the Congressional intent expressed in the enactment and subsequent legislative history of section 117(j).

122 Finally, the Commissioner contends that the findings of fact of the Tax Court that the short term rental cars had a useful life of 17 months and the long term rental cars had a useful life of three years each, and that each car of each class had a value of \$1,325 and \$600 respectively, must be accepted by this Court unless clearly erroneous. Such findings are conclusions of law, legal inferences from the evidentiary facts or, in any event, determinations of questions of law and fact. They were arrived at by the application of erroneous concepts of the terms "useful life" and "salvage value". Under such circumstances we are not bound by the "clearly erroneous" rule.³ *Curtis vs. Commissioner of Internal Revenue*, 232 F. 2d 167; *Helvering vs. Tex-Penn Oil Co.*, 300 U.S. 481.

The decision of the Tax Court is reversed and the cause remanded to the Tax Court for further hearing and proceedings for the redetermination of the tax liability of petitioners in a manner consistent with the views expressed herein.

[File endorsement omitted.]

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123 In United States Court of Appeals for the Ninth
Circuit

No. 15985

ROBLEY H. EVANS AND JULIA M. EVANS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Filed and Entered January 26, 1959

UPON PETITION TO REVIEW A DECISION OF THE TAX COURT OF THE
UNITED STATES

This cause came on to be heard on the Transcript of the Record from the Tax Court of the United States, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Tax Court in this cause be, and hereby is reversed, and that this cause be, and hereby is remanded to the said Tax Court for further hearing and proceedings for the redetermination of the tax liability of petitioners in a manner consistent with the views expressed in the opinion of this Court.

[File endorsement omitted.]

124 [Clerk's certificate to foregoing transcript omitted in
printing.]

125 Supreme Court of the United States

No. —, October Term, 1958

[Title omitted.]

Order extending time to file petition for writ of certiorari

April 23, 1959

Upon consideration of the application of counsel for petitioner(s),

It is ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including June 25, 1959.

WM. O. DOUGLAS,
Associate Justice of the Supreme
Court of the United States.

Dated this 23d day of April 1959.

126 Supreme Court of the United States

No. 143, October Term, 1959

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ROBLEY H. EVANS AND JULIA M. EVANS

Order allowing certiorari

October 12, 1959

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

127 *Petitioner's Exhibit No. 11*

ROBLEY H. EVANS, SEATTLE, WASHINGTON

Schedule of long term capital losses, Schedule D, Form 1040, December 31, 1946

Car No.	Date acquired	Date sold	Sales price	Cost	Deprecia- tion	Loss
602	6/30/45	2/28/46	\$750.00	\$1,095.00	\$305.20	\$130.71
633	8/31/44	2/28/46	700.00	1,115.00	325.21	80.79
407	8/31/45	7/31/46	950.00	1,433.00	358.32	124.66
983	3/31/45	10/31/46	800.00	1,444.50	511.53	132.97
Total			3,200.00	5,087.50	1,400.35	487.15

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ROBLEY H. EVANS, SEATTLE, WASHINGTON

Schedule of short term capital gains, Schedule D, Form 1040, December 31, 1946

Car No.	Date acquired	Date sold	Sales price	Cost	Deprecia- tion	Gain
484	7/31/46	10/31/46	\$1,617.74	\$1,617.74	\$101.10	\$101.10
227	7/31/46	11/30/46	1,780.95	1,603.13	133.60	311.42
332	8/31/46	12/31/46	1,667.74	1,647.60	137.28	157.42
Total			5,066.43	4,868.47	371.98	569.94

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ROBLEY H. EVANS, SEATTLE, WASHINGTON

Schedule of long term capital gains, Schedule D, Form 1040, December 31, 1946

Car No.	Date acquired	Date sold	Sales price	Cost	Deprecia- tion	Gain
399	2/28/41	2/28/46	\$285.00	\$1,089.80	\$1,089.80	\$285.00
101	8/31/41	8/31/46	800.00	1,024.44	1,024.44	800.00
011	9/30/40	9/30/46	600.00	1,023.38	1,023.38	600.00
006	10/31/49	10/31/46	775.00	820.05	820.05	775.00
214	10/31/44	10/31/46	850.00	1,639.68	819.84	30.16
460	10/31/41	10/31/46	500.00	621.09	621.09	500.00
592	10/31/41	10/31/46	575.00	750.00	750.00	575.00
020	8/31/40	10/31/46	800.00	819.16	819.16	800.00
408	10/31/41	10/31/46	900.00	1,003.24	1,003.24	900.00
013	12/31/40	12/31/46	925.00	859.46	800.46	875.00
200	8/31/42	12/31/46	1,500.00	2,089.42	1,871.79	1,282.37
Total			8,570.00	11,739.72	10,652.25	7,482.53

Petitioner's Exhibit No. 10

ROBLEY H. EVANS, SEATTLE, WASHINGTON

Schedule of long term capital gains, Schedule D, Form 1040, year ended December 31, 1947

Car No.	Date acquired	Date sold	Sales price	Cost	Depreciation	Book value	Gain
461	6/30/41	1/31/47	\$825.00	\$897.03	\$897.03		\$825.00
128	4/30/42	1/31/47	850.00	901.25	901.25		850.00
010	7/31/41	1/31/42	875.00	905.84	905.84		875.00
624	6/30/41	1/31/47	800.00	893.87	893.87		800.00
225		1/31/47	800.00	892.97	892.97		800.00
202	1/31/42	1/31/47	800.00	773.64	773.64		800.00
796	7/31/41	1/31/47	800.00	886.21	886.21		800.00
405	1/31/41	2/28/47	905.00	1,054.27	1,054.27		905.00
797	7/31/41	2/28/47	770.00	886.21	886.21		770.00
531	7/31/41	2/28/47	750.00	900.37	900.37		750.00
001	10/31/40	2/28/47	484.05	834.43	834.43		484.05
611	11/30/41	4/30/47	795.46	1,023.38	1,023.38		795.46
406	1/31/42	4/30/47	795.46	1,022.85	1,022.85		795.46
301	5/31/41	4/30/47	795.46	839.87	839.87		795.46
016	2/28/41	4/30/47	795.46	836.62	836.62		795.46
628	12/31/41	4/30/47	795.46	1,071.26	1,071.26		795.46
017	1/28/41	4/30/47	795.45	814.99	814.99		795.45
009	7/31/41	4/30/47	795.45	907.28	907.28		795.45
129	1/31/42	4/30/47	795.45	991.11	991.11		795.45
014	12/31/40	4/30/47	795.45	810.81	810.81		795.45
855	7/31/45	4/30/47	795.45	1,050.00	437.40	\$612.60	182.85
305	5/19/41	4/30/47	795.45	838.23	838.23		795.45
459	3/31/41	4/30/47	867.50	763.43	763.43		867.50
795	3/31/41	5/31/47	825.00	769.64	769.64		825.00
404	1/31/42	7/31/47	1,200.00	1,156.26	1,156.26		1,200.00
965	2/28/46	7/31/47	650.00	969.00	336.43	613.57	36.43
Ford Truck	12/31/46	7/31/47	1,200.00	1,357.85	108.03	1,159.82	40.18
072	4/30/46	10/31/47	1,525.00	1,301.25	487.98	813.27	711.73
002	4/30/46	10/31/47	1,750.00	1,304.76	490.86	813.90	936.10
930	11/30/46	10/31/47	1,400.00	1,420.96	312.09	1,108.87	291.13
003	4/30/46	10/31/47	1,350.00	1,304.76	490.86	813.90	536.10
572	7/31/46	10/31/47	1,350.00	674.74	191.76	482.98	867.02
198	10/31/46	12/31/47	1,471.78	1,435.96	388.96	1,046.99	424.79
171	3/1/47	9/30/47	1,449.00	1,384.25	144.25	1,240.00	209.00
882	1/31/47	9/30/47	1,545.00	1,540.65	223.96	1,316.69	228.31
370	12/31/46	9/30/47	1,300.00	577.10	71.77	505.33	794.67
Total			35,292.33	35,974.09	25,446.17	10,527.92	24,764.41

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ROBLEY H. EVANS, SEATTLE, WASHINGTON

Schedule of short term capital gains, Schedule D, Form 1040, year ended December 31, 1947

Car No.	Date acquired	Date sold	Sales price	Cost	Depr.	Book value	Gain
Detroit	6/30/47	6/30/47	\$1,210.00	\$1,203.50	\$32.46	\$1,203.50	\$6.50
Zeff	12/31/46	1/31/47	1,558.16	1,558.16	32.46	1,525.70	32.46
749	12/31/46	1/31/47	1,696.38	652.37	27.15	625.19	1,073.19
908	5/31/47	8/31/47	1,530.00	1,430.95	87.75	1,343.20	186.80
351	12/31/46	3/31/47	1,834.36	1,712.00	106.98	1,605.02	229.34
Total							1,528.29

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ROBLEY H. EVANS, SEATTLE, WASHINGTON

Schedule of long term capital losses, Schedule D, Form 1040, year ended December 31, 1947

Item	Date acquired	Date sold	Sales price	Cost	Depr.	Book value	Losses
653	9/30/45	7/31/47	\$600.00	\$1,400.00	\$489.93	\$910.07	\$310.07
Furniture	12/31/46	12/31/47	10.00	223.08	52.08	170.95	160.92
Total							471.02

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Petitioner's Exhibit No. 5

ROBLEY H. AND JULIA M. EVANS

Line 4. Schedule of short term capital gains, December 31, 1948

Automobiles No.	Date acquired	Date sold	Sale price	Deprec.	Cost	Profit
533	3/31/48	3/31/48	\$1,657.19		\$1,657.19	
426	4/30/48	4/30/48	1,677.06		1,603.94	\$73.12
834	2/28/48	4/30/48	1,762.24	\$66.72	1,642.90	186.06
782	6/30/48	7/31/48	1,740.77	30.05	1,442.40	328.42
214	9/30/48	10/31/48	2,115.00		2,114.36	.64
289	9/30/48	10/31/48	1,886.30	39.30	1,886.30	39.30
060	8/31/48	10/31/48	1,821.05	75.88	1,821.05	75.88
433	8/31/48	10/31/48	1,743.90	72.66	1,743.90	72.66
436	8/31/48	10/31/48	1,696.40	70.68	1,696.40	70.68
286	9/30/48	10/31/48	1,961.30	40.86	1,961.30	40.86
287	9/30/48	16/31/48	1,961.30	40.86	1,961.30	40.86
737	10/31/48	11/30/48	2,250.00	42.20	2,025.50	266.70
Total			22,272.51	479.21	21,556.54	1,195.18

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ROBLEY H. AND JULIA M. EVANS

*Line 5. Schedule of long term capital gains sale of office equipment,
Burroughs Adding Machine*

Date acquired	Date sold	Sale price	Deprec.	Cost	Profit
8/30/37	4/30/48	\$32.50	\$45.90	\$45.90	\$32.50

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ROBLEY H. AND JULIA M. EVANS

Line 5. Schedule of long term capital losses

Automobiles No.	Date ac- quired	Date sold	Sale price	Deprec.	Cost	Loss
347	2/28/47	5/31/48	\$950.00	\$396.24	\$1,359.01	\$12.77
348	10/31/47	10/31/48	550.00	354.61	1,418.50	713.89
Total			1,300.00	750.85	2,777.51	726.66

Line 5. Schedule of long term capital gains

Automobiles No.	Date acquired	Date sold	Sale price	Deprec.	Cost	Profit
201	1/31/47	1/31/48	\$1,350.00	\$189.65	\$858.76	\$880.80
445	9/30/46	1/31/48	1,350.00	453.28	1,382.55	420.73
418	8/31/46	1/31/48	1,425.00	221.92	665.70	961.22
231	9/30/46	1/31/48	1,425.00	517.44	1,552.18	390.28
259	12/31/46	1/31/48	1,400.00	414.39	1,575.51	238.88
477	2/28/47	2/28/48	1,500.00	287.59	1,289.45	468.13
137	9/30/46	2/28/48	1,500.00	503.68	1,436.01	567.67
884	12/31/46	2/28/48	1,450.00	391.19	1,368.05	473.14
279	2/28/47	2/28/48	1,500.00	322.00	1,458.00	44.00
027	9/30/46	2/28/48	1,416.66	180.87	504.12	1,093.41
086	6/30/47	2/28/48	1,416.67	230.34	1,407.56	239.05
149	9/30/46	2/28/48	1,416.67	312.10	943.40	785.37
828	12/31/46	2/28/48	1,500.00	391.38	1,362.25	529.13
680	6/30/47	2/28/48	1,575.00	238.38	1,473.97	339.41
473	8/31/47	2/28/48	1,650.00	246.66	1,502.52	394.14
502	7/31/47	3/31/48	1,660.00	243.01	1,477.57	365.44
(887)	(2/28/47)	(5/31/48)	(950.00)	(396.24)	(1,359.01)	(*)1277
305	4/30/47	6/30/48	1,000.00	426.87	1,134.08	322.79
843	8/31/46	6/30/48	1,000.00	583.65	1,275.92	307.73
092	11/30/46	6/30/48	1,400.00	478.35	1,235.35	643.23
419	8/31/46	7/31/48	1,371.60	709.98	1,491.40	590.18
420	5/31/47	7/31/48	1,371.60	388.44	1,448.48	311.36
582	9/30/47	7/31/48	1,371.60	303.78	1,400.90	214.48
725	10/31/46	7/31/48	1,371.60	362.52	864.66	869.46
757	7/31/47	7/31/48	1,371.60	375.34	1,514.32	232.62
041	7/31/46	7/31/48	1,400.00	281.90	637.92	1,043.66
003	10/31/46	7/31/48	840.00	593.71	1,381.17	52.54
576	10/31/46	9/30/48	1,300.00	348.78	751.70	597.06
336	11/30/46	9/30/48	1,200.00	564.35	1,234.15	532.69
361	1/31/47	9/30/48	1,175.00	618.35	1,517.87	275.57
278	2/28/47	10/31/48	1,575.00	606.80	1,534.90	646.90
(548)	(10/31/47)	(10/31/48)	(350.00)	(354.61)	(1,418.50)	(713.89)
170	12/31/46	10/31/48	1,650.00	597.45	1,350.84	866.61
633	12/31/47	10/31/48	1,553.69	323.70	1,553.69	323.70
283	8/31/47	10/31/48	1,484.71	433.12	1,484.71	433.12
948	6/30/47	10/31/48	1,278.66	423.42	1,278.66	423.43
733	8/31/47	10/31/48	1,352.06	394.39	1,352.06	394.39
060	4/30/47	10/31/48	1,367.97	459.30	1,367.97	459.30
399	5/31/47	10/31/48	1,392.88	463.23	1,392.88	463.23
753	7/31/47	10/31/48	1,425.26	443.49	1,425.26	443.49
768	3/31/47	10/31/48	1,390.85	518.60	1,390.85	518.60
769	3/31/47	10/31/48	1,390.86	518.60	1,390.86	518.60
618	10/31/47	10/31/48	1,526.87	380.95	1,526.87	380.95
800	10/31/47	10/31/48	1,423.44	355.01	1,423.44	355.01
874	9/31/47	10/31/48	1,335.31	360.47	1,335.31	360.47
453	5/31/47	10/31/48	1,362.38	478.61	1,362.38	478.61
757	2/28/48	10/31/48	1,616.16	269.36	1,616.16	269.36
758	2/28/48	10/31/48	1,616.16	269.36	1,616.16	269.36
183	3/31/47	10/31/48	1,150.00	539.53	1,408.72	280.71
463	10/31/46	10/31/48	1,150.00	726.92	1,463.90	413.92
537	8/31/47	10/31/48	1,550.00	461.82	1,583.01	425.81
100	11/30/46	11/30/48	1,673.08	693.83	1,420.26	946.65
Total			60,913.34	21,000.82	66,464.11	24,430.05

Matter in parentheses () signifies canceled.

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Respondent's Exhibit A

ROBLEY H. AND JULIA M. EVANS

Schedule D. Schedule of short term capital gains, December 31, 1949

Car No.	Date pur.	Date sold	Sale price.	Deprec.	Cost.	Profit
178	7/31/49	9/30/49	\$1,550.00	\$62.56	\$1,501.64	\$110.92
134	5/31/49	10/31/49	1,475.00	162.46	1,573.54	63.92
189	8/ 2/49	10/31/49	1,475.00	56.88	1,391.78	140.10
215	12/31/49	12/31/49	1,517.35		1,517.35	
Total			6,017.35	281.90	5,984.31	314.94

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ROBLEY H. AND JULIA M. EVANS

Schedule D. Schedule of long term capital gains

Car No.	Date pur.	Date sold	Sale price	Deprec.	Cost	Profit
101	12/31/45	1/31/49	\$1,300.00	\$770.93	\$1,440.02	\$630.91
138	9/30/46	1/31/49	1,330.00	862.72	1,436.01	776.71
402	8/31/46	1/31/49	1,000.00	717.06	1,160.65	557.01
686	9/30/46	1/31/49	1,324.50	759.11	1,268.90	814.71
879	4/30/47	1/31/49	1,400.00	643.02	1,469.89	573.13
902	10/31/46	2/28/49	1,265.00	844.01	1,434.05	674.96
192	2/28/47	2/28/49	1,250.00	761.86	1,542.59	469.27
229	2/28/47	2/28/49	1,300.00	679.56	1,366.42	613.14
297	10/31/46	2/28/49	1,325.00	813.72	1,343.52	795.20
337	11/30/46	2/28/49	1,300.00	800.44	1,390.49	709.95
457	4/30/47	2/28/49	1,300.00	616.92	1,350.84	566.08
745	1/31/47	2/28/49	1,250.00	721.00	1,429.58	541.42
877	4/30/47	2/28/49	1,300.00	668.83	1,470.38	496.45
889	2/28/47	2/28/49	1,325.00	697.10	1,394.26	627.84
940	7/31/46	3/31/49	1,250.00	396.68	637.62	1,008.06
962	3/31/48	3/31/49	1,600.00	395.25	1,589.47	405.78
230	2/28/47	3/31/49	1,200.00	686.82	1,400.45	586.37
231	2/28/47	3/31/49	1,235.00	678.22	1,374.06	539.16
286	4/30/47	3/31/49	1,235.00	662.28	1,450.60	446.68
303	9/30/46	3/31/49	1,250.00	852.49	1,398.26	704.23
372	3/31/47	3/31/49	1,235.00	677.31	1,419.50	492.81
558	1/31/47	3/31/49	1,300.10	740.04	1,429.35	610.79
687	9/30/46	3/31/49	1,300.00	809.62	1,323.17	686.45
759	12/31/47	3/31/49	1,350.00	652.38	1,470.83	331.55
829	6/30/47	3/31/49	1,300.00	546.44	1,257.84	588.60
830	6/30/47	3/31/49	1,235.00	642.89	1,248.89	628.50
831	6/30/47	3/31/49	1,300.00	544.48	1,233.09	491.39
918	7/31/47	3/31/49	1,300.00	599.65	1,441.61	358.04
919	7/31/47	3/31/49	1,250.00	597.32	1,438.22	409.10
949	6/30/47	3/31/49	1,375.00	531.62	1,507.16	399.46
949	10/31/47	3/31/49	1,250.00	572.28	1,277.98	544.30
954	7/31/47	3/31/49	1,425.00	641.52	1,547.16	519.26
190	8/31/47	4/30/49	1,250.00	613.79	1,475.00	388.79
194	4/30/47	4/30/49	1,450.00	654.28	1,438.59	695.99
303	2/28/47	4/30/49	900.00	711.75	1,366.50	245.25
476	2/28/47	4/30/49	1,800.00	663.62	1,289.45	674.17
486	12/31/46	4/30/49	1,100.00	806.12	1,381.93	524.19
536	9/30/47	4/30/49	1,250.00	612.73	1,548.90	313.83
629	12/31/47	4/30/49	1,450.00	532.96	1,599.19	383.77

Schedule D. Schedule of long term capital gains—Continued

Car No.	Date pur.	Date sold	Sale price	Deprec.	Cost	Profit
639	12/31/47	4/30/49	\$1,450.00	\$367.85	\$1,705.55	\$312.30
126	3/31/47	5/30/49	1,300.00	755.42	1,451.50	603.92
356	1/31/47	5/31/49	1,000.00	799.60	1,429.35	370.25
486	4/30/47	5/31/49	1,250.00	680.17	1,370.59	559.58
566	2/28/48	5/31/49	1,500.00	516.15	1,651.51	64.64
821	8/31/47	5/31/49	1,340.00	649.95	1,485.77	504.18
255	4/30/47	6/30/49	1,250.00	738.97	1,424.15	564.2
832	6/30/47	6/30/49	1,250.00	618.49	1,241.66	626.83
802	7/31/47	6/30/49	1,250.00	803.50	1,685.19	368.31
756	6/30/47	6/30/49	1,250.00	822.84	1,283.09	619.55
658	12/31/49	6/30/49	1,300.00	569.66	1,563.93	305.73
326	12/31/47	6/30/49	1,340.00	565.24	1,510.00	356.24
463	12/31/47	6/30/49	1,225.00	552.88	1,478.16	305.72
905	5/31/47	6/30/49	1,225.00	727.07	1,459.08	492.90
547	10/31/47	6/30/49	1,300.00	604.69	1,454.95	449.74
139	10/31/47	6/30/49	1,250.00	508.61	1,460.79	297.82
243	12/31/47	7/31/49	1,250.00	587.69	1,481.08	356.61
260	8/31/47	7/31/49	1,125.00	802.68	1,672.81	254.84
723	10/31/48	8/31/49	1,500.00	382.70	1,836.87	43.83
174	12/31/47	9/30/49	1,225.00	688.82	1,570.39	343.43
532	8/31/47	9/30/49	1,075.00	782.75	1,502.90	354.85
680	12/31/47	9/30/49	1,025.00	696.30	1,592.98	128.32
064	10/31/47	9/30/49	1,125.00	800.11	1,669.74	255.37
065	10/31/47	9/30/49	1,100.00	800.20	1,669.74	230.46
079	11/30/47	9/30/49	1,300.00	743.28	1,623.42	470.86
091	3/31/48	9/30/49	1,125.00	590.76	1,613.52	192.24
177	6/30/48	9/30/49	1,225.00	514.06	1,682.02	87.04
187	8/31/47	9/30/49	1,125.00	790.48	1,621.02	294.46
243	9/30/48	9/30/49	1,200.00	367.12	1,476.98	99.14
244	9/30/48	9/30/49	1,225.00	367.12	1,476.98	115.14
067	7/31/48	9/30/49	1,250.00	490.15	1,683.09	57.06
284	7/31/48	9/30/49	1,345.00	463.92	1,613.35	197.52
645	12/31/47	9/30/49	1,100.00	667.40	1,570.68	196.75
686	12/31/47	9/30/49	1,025.00	697.15	1,594.98	127.17
754	1/31/48	9/30/49	1,140.00	696.60	1,672.61	163.99
755	1/31/48	9/30/49	1,025.00	696.60	1,672.61	48.99
756	1/31/48	9/30/49	1,100.00	696.60	1,672.62	123.98
758	12/31/47	9/30/49	1,025.00	630.63	1,481.17	194.46
836	2/28/48	9/30/49	975.00	599.07	1,519.16	84.91
864	3/31/48	9/30/49	1,150.00	596.07	1,594.06	152.01
866	8/31/48	9/30/49	1,225.00	395.79	1,465.29	155.50
904	5/31/47	9/30/49	1,025.00	836.67	1,493.67	367.60
074	12/31/47	9/30/49	1,025.00	657.32	1,509.54	181.78
110	3/31/48	10/31/49	1,050.00	616.36	1,560.29	106.07
155	4/30/48	10/31/49	1,250.00	551.56	1,475.79	325.77
407	4/30/48	10/31/49	1,200.00	526.64	1,406.75	319.89
799	6/30/48	10/31/49	1,200.00	522.06	1,569.29	152.77
948	12/31/48	10/31/49	1,400.00	354.75	1,730.09	24.69
803	7/31/47	10/31/49	1,300.00	736.27	1,615.15	421.12
094	7/31/48	12/31/49	1,290.00	573.50	1,639.96	239.54
076	7/31/48	12/31/49	1,290.00	595.23	1,682.20	203.03
101	4/31/49	12/31/49	1,600.00	305.36	1,832.20	73.16
102	9/30/48	12/31/49	1,300.00	499.74	1,603.22	66.52
159	5/31/48	12/31/49	1,090.00	620.21	1,569.29	140.92
167	5/31/48	12/31/49	1,090.00	555.01	1,406.79	238.22
242	9/30/48	12/31/49	1,175.00	430.61	1,476.99	157.62
408	4/30/48	12/31/49	835.96	598.15	1,431.11	
428	4/30/48	12/31/49	1,100.00	684.21	1,645.80	138.41
440	4/30/48	12/31/49	1,060.00	651.41	1,567.43	173.98

Schedule D. Schedule of long term capital gains—Continued

Car No.	Date pur.	Date sold	Sale price	Deprec.	Cost	Profit
444	10/31/48	12/31/49	\$1,390.00	\$502.94	\$1,731.18	\$161.79
752	12/31/48	12/31/49	1,350.00	433.32	1,733.43	40.89
803	10/31/47	12/31/49	750.00	856.94	1,568.13	28.81
835	2/38/48	12/31/49	1,090.00	711.04	1,551.30	249.74
858	8/31/48	12/31/49	1,200.00	563.84	1,091.65	72.19
879	7/31/48	12/31/49	1,290.00	613.91	1,735.04	168.87
929	6/30/48	12/31/49	1,090.00	513.14	1,370.69	232.45
931	6/30/48	12/31/49	1,090.00	509.56	1,362.96	236.65
932	6/30/48	12/31/49	1,090.00	509.01	1,359.94	239.07
933	7/31/48	12/31/49	1,390.00	502.76	1,731.36	161.40
Total			131,985.56	67,881.98	161,587.95	38,279.59

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Respondent's Exhibit B

Schedule of long term loss, December 31, 1950

Car	Date pur.	Date sold	Selling	Cost	Res	Profit
868	9/30/48	5/31/50	\$1,100.00	\$1,895.23	\$788.18	\$7.05
682	11/31/48	6/30/50	1,150.00	1,903.53	752.44	1.09
Total			2,250.00	3,798.76	1,540.62	8.14

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Schedule of short term gain

Car	Date pur.	Date sold	Selling	Cost	Res	Profit
758	7/31/50	7/31/50	\$1,648.32	\$1,533.08		\$115.24
802	9/30/50	9/30/50	1,867.00	1,698.00		169.00
800	9/30/50	10/31/50	1,921.03	1,751.63	\$36.50	205.87
308	8/31/50	11/30/50	1,565.00	1,560.51	96.89	101.38
369	6/30/50	11/30/50	1,600.00	1,438.20	147.50	309.30
801	9/30/50	11/30/50	2,250.00	2,105.66	87.74	232.08
Total			10,851.32	10,087.08	368.63	1,132.87

Schedule of long term capital gains, 1950

Car No.	Date pur.	Date sold	Sale price	Cost	Deprge.	Gain
241	9/30/48	1/31/50	\$1,100.00	\$1,476.98	\$490.44	\$113.46
867	4/30/47	1/31/50	1,475.00	1,846.34	1,230.88	859.54
139	8-2/49	2/14/50	1,400.00	1,581.51	196.25	14.74
180	7/31/49	2/28/50	1,425.00	1,628.52	234.64	31.12
263	7/31/48	2/28/50	1,150.00	1,634.33	645.26	160.93
464	2/28/48	2/28/50	975.00	1,545.91	770.54	199.63
726	12/31/48	2/28/50	1,325.00	1,724.33	497.86	98.55
781	6/30/48	2/28/50	1,125.00	1,487.24	618.46	256.22
784	6/30/48	2/28/50	1,125.00	1,488.13	618.82	255.69
857	8/31/48	2/28/50	1,125.00	1,729.21	646.29	42.08
125	3/31/48	3/31/50	1,000.00	1,560.29	778.66	218.37
172	9/30/48	3/31/50	1,050.00	1,603.21	600.06	46.85
373	3/31/47	3/31/50	500.00	1,386.25	1,010.61	124.36
436	4/30/48	3/31/50	1,050.00	1,645.80	787.26	191.46
753	6/30/48	3/31/50	1,525.00	1,487.24	649.48	687.24
829	6/30/48	3/31/50	1,125.00	1,569.29	685.65	241.36
804	10/31/47	3/31/50	1,000.00	1,568.13	944.89	376.76
947	12/31/48	3/31/50	1,300.00	1,742.10	540.10	98.00
867	9/30/48	3/31/50	1,200.00	1,895.22	709.12	13.90
046	11/30/48	4/30/50	1,250.00	1,886.02	653.12	17.10
129	5/31/48	4/30/50	1,075.00	1,406.79	673.34	341.55
406	4/30/48	4/30/50	1,075.00	1,406.76	702.68	370.92
553	4/30/48	4/30/50	1,075.00	1,560.28	779.48	294.20
578	6/30/48	4/30/50	1,000.00	1,634.32	746.74	112.42
607	7/31/48	4/30/50	1,000.00	1,660.34	724.82	64.48
727	12/31/48	4/30/50	1,175.00	1,719.68	569.76	25.08
166	5/31/48	4/30/50	1,275.00	1,402.84	609.11	541.27
196	10/10/49	4/26/50	1,775.00	1,795.91	221.36	300.45
182	12/31/48	4/30/50	1,195.00	1,730.42	573.28	37.86
193	8/31/49	4/30/50	1,206.00	1,442.01	235.92	
909	4/30/47	4/30/50	1,000.00	1,791.03	1,305.85	514.82
105	3/31/49	5/31/50	1,400.00	1,867.30	544.00	77.30
109	3/31/49	5/31/50	1,400.00	1,825.56	532.42	106.92
119	4/30/49	5/31/50	1,400.00	1,636.34	441.52	202.18
126	8/31/49	5/31/50	1,300.00	1,580.65	293.70	13.05
129	5/30/49	5/31/50	1,200.00	1,512.63	375.66	63.08
133	4/30/49	5/31/50	1,400.00	1,658.19	446.72	188.53
140	7/31/48	5/31/50	1,110.00	1,581.13	721.40	250.27
168	5/31/48	5/31/50	1,110.00	1,399.86	697.48	407.62
245	12/31/47	5/31/50	1,315.00	1,585.68	959.33	688.65
463	3/31/48	5/31/50	1,110.00	1,600.79	804.76	373.97
490	10/31/48	5/31/50	1,275.00	1,733.19	685.27	227.08
689	7/31/48	5/31/50	1,110.00	1,566.21	715.15	258.94
706	8/31/48	5/31/50	1,160.00	1,765.16	771.88	166.72
741	10/31/48	5/31/50	1,280.00	1,917.05	754.46	117.41
909	10/31/48	5/31/50	1,275.00	1,741.90	687.89	220.99
930	6/30/48	5/31/50	1,200.00	1,359.94	650.81	400.87
105	3/31/49	6/30/50	1,400.00	1,793.50	560.40	166.90
104	3/31/49	6/30/50	1,500.00	1,867.30	583.50	216.20
112	4/30/49	6/30/50	1,525.00	1,871.54	543.38	190.84
131	4/30/49	6/30/50	1,500.00	1,510.40	440.58	430.18
144	6/30/49	6/30/50	1,600.00	1,806.30	445.36	239.06
117	4/30/49	6/30/50	1,520.00	1,639.34	475.74	356.40
103	1/31/49	6/30/50	1,325.00	2,009.46	711.62	27.16
018	11/30/48	6/30/50	1,325.00	2,072.00	816.64	69.64
122	5/30/49	6/30/50	1,425.00	1,436.65	389.09	377.44
118	4/30/49	6/30/50	1,500.00	1,639.34	475.74	336.40

Schedule of long term capital gains, 1950—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
132	5/30/49	6/30/50	\$1,425.00	\$1,510.40	\$409.11	\$323.71
138	6/30/49	6/30/50	1,500.00	1,684.43	419.94	235.51
145	6/30/49	6/30/50	1,600.00	1,806.31	445.36	239.05
184	8/31/49	6/30/50	1,578.00	1,627.66	336.64	283.98
113	4/30/49	6/30/50	1,525.00	1,859.78	541.32	206.54
100	3/31/49	6/30/50	1,450.00	1,879.30	587.25	157.95
137	6/30/49	6/30/50	1,450.00	1,685.14	421.32	186.18
160	6/30/49	6/30/50	1,450.00	1,684.43	419.94	185.51
143 176	5/31/49	6/30/50	1,450.00	1,744.14	469.99	175.85
190	8/31/49	6/30/50	1,450.00	1,628.51	336.17	156.66
200	8/31/49	6/30/50	1,425.00	1,613.69	336.20	147.51
106	3/31/49	7/31/50	1,500.00	2,083.79	693.19	109.40
114	5/31/49	7/31/50	1,450.00	1,870.14	544.38	124.24
115	5/31/49	7/31/50	1,500.00	1,861.69	541.84	180.15
120	5/31/49	7/31/50	1,500.00	1,508.22	430.55	422.63
121	5/31/49	7/31/50	1,400.00	1,436.65	419.02	382.37
124	5/31/49	7/31/50	1,400.00	1,436.65	419.02	382.37
127	5/31/49	7/31/50	1,400.00	1,453.65	419.50	365.85
128	5/31/49	7/31/50	1,400.00	1,512.64	438.82	326.18
130	4/30/49	7/31/50	1,500.00	1,698.69	528.43	379.74
136	6/30/49	7/31/50	1,400.00	1,572.86	409.44	236.58
141	5/31/49	7/31/50	1,400.00	1,782.69	518.76	136.07
142	5/31/49	7/31/50	1,400.00	1,734.90	503.64	168.65
148	6/30/49	7/31/50	1,425.00	1,758.94	474.91	140.97
150	6/30/49	7/31/50	1,425.00	1,758.94	474.91	140.97
153	6/30/49	7/31/50	1,500.00	1,758.94	474.91	215.97
161	7/31/49	7/31/50	1,500.00	1,684.43	421.20	236.77
171	7/31/49	7/31/50	1,500.00	1,683.69	419.61	235.97
175	5/31/49	7/31/50	1,400.00	1,743.44	506.16	162.72
191	8/31/49	7/31/50	1,475.00	1,441.16	326.88	360.72
194	8/31/49	7/31/50	1,500.00	1,581.51	358.50	276.99
198	8/31/49	7/31/50	1,525.00	1,683.69	385.88	227.19
202	8/31/49	7/31/50	1,500.00	1,685.32	382.29	196.97
207	11/30/49	7/31/50	1,500.00	1,495.83	244.45	248.62
208	11/30/49	7/31/50	1,500.00	1,488.02	241.63	253.61
116	4/30/49	8/31/50	1,620.00	1,639.34	544.18	524.84
135	5/30/49	8/31/50	1,600.00	1,496.85	467.70	470.85
162	7/31/49	8/31/50	1,620.00	1,684.43	456.30	391.87
170	7/31/49	8/31/50	1,675.00	1,692.66	467.06	439.40
201	8/31/49	8/31/50	1,600.00	1,641.48	409.17	367.69
211	11/30/49	8/31/50	1,600.00	1,547.02	289.38	342.36
107	3/31/49	9/30/50	1,550.00	1,825.50	684.54	409.04
149	6/30/49	9/30/50	1,435.00	1,785.94	548.25	224.31
154	6/30/49	9/30/50	1,435.00	1,758.94	548.25	224.31
179	7/31/49	9/30/50	1,600.00	1,627.65	470.96	443.31
182	8/31/49	9/30/50	1,500.00	1,580.65	425.68	345.03
183	8/31/49	9/30/50	1,600.00	1,627.65	438.64	410.98
192	8/31/49	9/30/50	1,550.00	1,442.02	389.46	497.38
205	11/30/49	9/30/50	1,348.50	1,486.89	303.80	165.41
214	12/31/49	9/30/50	1,600.00	1,560.58	292.50	331.67
220	12/31/49	9/30/50	1,450.00	1,308.98	261.39	312.41
226	12/31/49	9/30/50	1,600.00	1,661.72	302.51	240.79
897	8/31/48	9/30/50	1,100.00	1,440.87	749.57	408.70
164	7/31/49	10/31/50	1,600.00	1,683.68	524.91	449.23
147	7/31/49	11/30/50	991.87	1,484.51	492.64	
151	6/30/49	11/30/50	1,500.00	1,758.94	621.59	362.65
173	7/31/49	11/30/50	1,400.00	1,642.84	547.52	304.68
181	8/31/49	11/30/50	1,400.00	1,486.51	462.77	378.26
206	11/30/49	11/30/50	1,375.00	1,495.83	369.57	248.74

Schedule of long term capital gains, 1950—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
209	11/30/49	11/30/50	\$1,450.00	\$1,440.73	\$358.50	\$367.77
210	11/30/49	11/30/50	1,400.00	1,547.02	386.04	239.02
221	11/30/49	11/30/50	1,500.00	1,720.54	430.20	209.66
225	12/30/49	11/30/50	1,350.00	1,567.43	358.34	140.91
705	8/31/48	11/30/50	1,050.00	1,765.16	992.62	277.45
111	4/50/49	12/31/50	1,450.00	1,699.02	706.96	457.94
143	5/31/49	12/31/50	1,450.00	1,882.88	741.70	368.42
163	7/31/49	12/31/50	1,350.00	1,683.68	595.11	261.43
188	8/31/49	12/31/50	1,390.00	1,442.01	479.64	337.63
195	8/31/49	12/31/50	1,350.00	1,703.12	864.18	211.06
199	8/31/49	12/31/50	1,450.00	1,686.15	559.82	323.67
213	11/30/49	12/31/50	1,450.00	1,470.15	414.06	390.91
253	3/31/50	12/31/50	1,450.00	1,516.61	284.40	217.79
326	5/31/50	12/31/50	1,700.00	1,682.10	241.64	278.54
359	5/31/50	12/31/50	1,486.89	1,738.82	251.93	
379	6/30/50	12/31/50	1,450.00	2,438.20	177.50	139.30
Total			180,328.35	216,844.50	69,994.23	33,478.08

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Respondent's Exhibit C

ROBLEY H. AND JULIA M. EVANS

Schedule of short term capital gains, 1951

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
803	2/18/51	2/28/51	\$1,858.97	\$1,771.48		\$87.49
1001	3/23/51	5/31/51	1,936.96	1,837.53	\$76.98	199.41
1002	4/2/51	5/31/51	1,619.60	1,544.31	32.17	107.46
122	4/2/51	7/31/51	1,650.00	1,506.79	94.17	237.36
144	5/10/51	7/31/51	1,682.00	1,547.08	64.46	199.38
146	5/10/51	8/31/51	1,685.00	1,547.08	96.69	234.61
496	5/10/51	8/31/51	1,474.00	1,547.08	96.69	23.61
Total			11,906.53	11,311.35	461.16	1,056.34

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ROBLEY H. AND JULIA M. EVANS

Schedule of long term capital gains, 1951

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
156	5/21/49	1/31/51	\$1,275.00	\$1,436.65	\$598.00	\$436.65
218	12/12/49	1/31/51	1,375.00	1,529.41	411.92	257.51
224	1/28/49	1/31/51	1,350.00	1,615.58	438.63	173.05
261	3/22/50	1/31/51	1,600.00	1,607.71	333.62	335.91
367	6/8/50	1/31/51	1,600.00	1,408.73	207.65	398.92
223	12/28/49	2/28/51	1,400.00	1,615.58	472.50	256.92
146	4/22/49	3/31/51	1,450.00	1,483.66	614.96	561.30
222	12/28/49	3/31/51	1,400.00	1,624.33	506.91	282.58
227	12/28/49	3/31/51	1,475.00	1,636.22	510.37	349.15
268	4/18/50	3/31/51	1,680.00	1,606.66	366.83	440.17
248	5/19/50	3/31/51	1,475.00	1,488.83	287.94	374.01

Schedule of long term capital gains, 1951—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
375	6/16/50	3/31/51	\$1,475.00	\$1,408.73	\$263.09	\$329.36
197	10/10/49	4/30/51	1,485.00	1,490.01	551.97	549.56
203	10/10/49	4/30/51	1,400.00	1,412.72	527.95	515.22
217	12/12/49	4/30/51	1,600.00	1,545.62	513.18	567.56
228	1/31/50	4/30/51	1,490.00	1,613.48	504.30	380.82
229	3/ 3/50	4/30/51	1,525.00	1,504.15	423.54	184.39
276	4/25/50	4/30/51	1,600.00	1,575.80	394.44	411.58
437	8/21/50	4/30/51	1,575.00	1,555.21	250.56	322.35
441	8/21/50	4/30/51	1,830.00	1,794.00	298.95	374.95
165	7/ 1/49	5/31/51	1,225.00	1,683.69	770.61	311.92
186	5/ 2/49	5/31/51	1,200.00	1,483.12	643.62	300.50
335	5/12/50	5/31/51	1,430.00	1,378.55	315.16	396.61
338	6/28/50	5/31/51	1,430.00	1,421.43	324.53	333.05
339	6/28/50	5/31/51	1,082.25	1,433.31	321.06	
386	5/15/50	5/31/51	1,220.00	1,421.01	294.76	63.75
212	8/ 2/49	6/30/51	1,250.00	1,580.65	722.88	392.03
232	3/13/50	6/30/51	1,300.00	1,423.00	413.92	320.92
234	3/22/50	6/30/51	1,300.00	1,423.00	413.92	320.92
213	4/13/50	6/30/51	1,300.00	1,376.85	401.52	324.67
255	3/ 3/50	6/30/51	1,300.00	1,502.56	487.12	224.56
259	3/ 3/50	6/30/51	1,300.00	1,543.25	473.54	230.29
260	3/ 3/50	6/30/51	1,300.00	1,500.15	480.42	226.27
290	6/ 5/50	6/30/51	1,300.00	1,703.33	425.76	22.43
312	5/18/50	6/30/51	1,300.00	1,364.61	368.09	363.48
313	5/18/50	6/30/51	1,300.00	1,352.31	373.55	291.24
319	5/18/50	6/30/51	1,300.00	1,423.00	384.60	261.60
331	5/10/50	6/30/51	1,300.00	1,344.61	364.00	319.99
185	8/ 2/49	7/31/50	1,100.00	1,484.51	508.59	324.08
204	11/ 4/49	7/31/50	1,050.00	1,486.87	614.30	177.43
230	3/ 8/50	7/31/50	1,350.00	1,376.85	458.88	432.03
231	3/13/50	7/31/50	1,350.00	1,423.00	473.58	400.58
233	3/13/50	7/31/50	1,360.00	1,424.15	474.03	349.88
249	4/25/50	7/31/50	1,350.00	1,336.15	417.45	431.30
265	4/18/50	7/31/50	1,450.00	1,606.66	500.79	544.13
277	5/ 9/50	7/31/50	1,350.00	1,536.73	447.70	260.97
282	5/ 9/50	7/31/51	1,350.00	1,570.49	456.93	236.44
249	5/10/50	7/31/51	1,375.00	1,570.47	456.93	261.46
291	6/12/50	7/31/51	1,350.00	1,560.87	422.31	211.44
292	6/12/50	7/31/51	1,475.00	1,560.86	422.31	336.45
295	5/18/50	7/31/51	1,375.00	1,711.79	498.23	161.44
296	5/18/50	7/31/51	1,400.00	1,711.79	498.23	186.44
297	5/18/50	7/31/51	1,350.00	1,711.79	498.23	136.44
303	3/22/50	7/31/51	1,325.00	1,596.99	531.23	259.24
304	3/22/50	7/31/51	1,400.00	1,712.59	560.75	237.16
316	5/18/50	7/31/51	1,350.00	1,382.30	396.64	394.34
328	6/12/50	7/31/51	1,450.00	1,421.01	383.84	412.83
146	6/12/50	7/31/51	1,300.00	1,378.54	372.64	294.10
346	5/10/50	7/31/51	1,375.00	1,425.08	414.26	364.18
337	5/18/50	7/31/51	1,375.00	1,438.20	416.58	353.38
361	5/25/50	7/31/51	1,300.00	1,401.95	406.08	304.13
370	6/12/50	7/31/51	1,400.00	1,438.20	387.50	349.30
410	9/11/50	7/31/51	1,325.00	1,332.38	277.60	270.22
674	10/31/48	7/31/51	550.00	1,529.50	1,051.71	72.11
235	3/22/50	8/31/51	1,400.00	1,425.28	503.31	478.03
240	4/13/50	8/31/51	1,400.00	1,376.85	458.88	482.03
241	4/13/50	8/31/51	1,400.00	1,423.00	473.58	450.58
246	4/17/50	8/31/51	1,365.00	1,423.00	473.58	415.58
262	3/22/50	8/31/51	1,365.00	1,600.65	567.94	326.20
269	4/18/50	8/31/51	1,400.00	1,616.56	537.75	321.19

Schedule of long term capital gains, 1951—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
271	4/25/50	8/31/51	\$1,470.00	\$1,606.72	\$534.28	\$397.56
272	4/25/50	8/31/51	1,400.00	1,606.72	534.28	327.56
273	4/25/50	8/31/51	1,400.00	1,603.35	533.98	328.63
274	4/25/50	8/31/51	1,400.00	1,614.27	537.00	322.73
286	5/10/50	8/31/51	1,470.00	1,570.47	489.68	380.21
290	6/ 5/50	8/31/51	1,365.00	1,578.67	460.32	247.24
320	5/18/50	8/31/51	1,425.00	1,382.11	430.45	473.13
321	5/18/50	8/31/51	1,400.00	1,423.00	443.92	420.92
322	5/25/50	8/31/51	1,365.00	1,421.02	442.00	386.58
343	6/28/50	8/31/51	1,365.00	1,378.53	400.64	387.11
347	5/10/50	8/31/51	1,375.00	1,418.89	441.57	397.68
350	5/10/50	8/31/51	1,375.00	1,390.16	427.26	412.10
354	5/10/50	8/31/51	1,375.00	1,380.26	431.25	425.90
356	5/10/50	8/31/51	1,405.00	1,425.08	443.99	418.91
368	6/ 8/50	8/31/51	1,375.00	1,438.20	417.50	354.30
373	6/15/50	8/31/51	1,375.00	1,408.73	410.06	376.33
423	5/16/49	9/30/51	1,200.00	1,512.64	880.94	508.30
457	5/23/50	9/30/51	1,050.00	1,512.63	880.94	418.31
263	4/18/50	9/30/51	1,500.00	1,743.87	615.90	372.12
281	5/ 9/50	9/30/51	1,425.00	1,582.89	526.44	368.55
294	5/18/50	9/30/51	1,425.00	1,711.79	569.63	282.84
298	5/18/50	9/30/51	1,425.00	1,711.80	569.63	282.83
317	5/18/50	9/30/51	1,400.00	1,382.30	459.28	476.98
334	6/22/50	9/30/51	1,430.00	1,403.32	438.26	464.54
336	6/28/50	9/30/51	1,400.00	1,421.42	443.20	421.78
337	6/28/50	9/30/51	1,475.00	1,415.01	430.20	480.19
349	5/10/50	9/30/51	1,375.00	1,280.26	400.13	87
352	5/10/50	9/30/51	1,375.00	1,401.94	464.77	437.83
353	5/10/50	9/30/51	1,475.00	1,388.83	461.72	447.89
360	5/25/50	9/30/51	1,375.00	1,401.95	464.64	437.60
363	5/26/50	9/30/51	1,375.00	1,401.95	464.64	437.66
364	5/26/50	9/30/51	1,375.00	1,380.26	400.00	454.74
366	6/ 8/50	9/30/51	1,400.00	1,408.73	447.89	439.16
360	6/13/50	9/30/51	1,425.00	1,438.19	447.50	434.31
381	6/16/50	9/30/51	1,380.00	1,448.19	447.50	389.31
382	5/26/50	9/30/51	1,325.00	1,380.26	400.00	504.74
383	5/26/50	9/30/51	1,375.00	1,423.08	473.72	423.64
428	9/25/50	9/30/51	1,400.00	1,560.56	380.75	229.19
436	8/21/50	9/30/51	1,425.00	1,503.21	407.16	328.96
248	4/17/50	10/31/51	1,475.00	1,582.30	516.94	596.64
267	4/18/50	10/31/51	1,425.00	1,560.51	584.00	440.00
285	5/10/50	10/31/51	1,400.00	1,582.87	559.44	376.67
300	3/22/50	10/31/51	1,300.00	1,589.34	628.10	538.76
309	8/23/50	10/31/51	1,400.00	1,561.51	453.49	291.96
315	5/18/50	10/31/51	1,400.00	1,382.30	488.79	506.49
318	5/18/50	10/31/51	1,400.00	1,382.30	488.79	506.49
333	6/22/50	10/31/51	1,425.00	1,421.01	473.28	477.27
352	5/26/50	10/31/51	1,325.00	1,401.95	403.92	416.97
371	6/12/50	10/31/51	1,523.12	1,438.20	477.50	562.42
375	6/16/50	10/31/51	1,425.00	1,380.26	460.00	504.74
388	7/31/50	10/31/51	1,400.00	1,421.43	444.30	422.77
391	7/31/50	10/31/51	1,425.00	1,421.00	443.28	447.20
392	7/31/50	10/31/51	1,425.00	1,421.00	443.28	447.20
395	8/11/50	10/31/51	1,425.00	1,421.05	413.70	417.60
407	8/15/50	10/31/51	1,425.00	1,374.85	400.96	451.11
413	10/11/50	10/31/51	1,400.00	1,374.85	343.68	308.83
414	11/10/50	10/31/51	1,350.00	1,263.00	289.52	376.52
431	8/21/50	10/31/51	1,450.00	1,503.21	438.48	385.27

Schedule of long term capital gains, 1951—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprac.	Gain
446	9/22/50	10/31/51	\$1,400.00	\$1,608.00	\$460.20	\$162.20
242	4/13/50	11/31/51	1,350.00	1,426.08	563.64	487.56
280	5/ 9/50	11/31/51	1,400.00	1,570.46	587.93	417.47
323	5/26/50	11/31/51	1,495.00	1,421.00	581.60	605.60
365	5/26/50	11/31/51	1,435.00	1,998.73	536.70	502.97
389	7/31/50	11/31/51	1,350.00	1,378.90	459.16	430.20
432	8/21/50	11/31/51	1,375.00	1,503.21	569.80	341.59
434	8/21/50	11/31/51	1,400.00	1,503.21	469.80	366.59
444	9/22/50	11/31/51	1,400.00	1,751.63	510.96	159.23
105	4/30/50	12/31/51	1,562.77	1,869.75	306.98	
126	4/ 2/51	12/31/51	1,286.95	1,544.31	257.36	
335	6/28/50	12/31/51	1,406.00	1,421.42	532.24	510.82
Total long term.			193,130.09	208,681.65	65,634.75	50,108.19

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Respondent's Exhibit D

ROBBY H. AND JULIA M. EVANS

Schedule of long term capital gains, 1952

Car No.	Date pur.	Date sold	Sale price	Cost	Deprac.	Gain
216	12/ 2/49	1/31/52	\$975.00	\$1,482.01	\$774.50	\$200.46
226	3/22/50	1/31/52	1,300.00	1,423.01	650.96	527.95
237	3/22/50	1/31/52	1,300.00	1,423.01	651.54	528.53
238	3/22/50	1/31/52	1,250.00	1,424.15	652.17	591.02
239	3/22/50	1/31/52	1,325.00	1,378.85	630.96	576.11
244	4/13/50	1/31/52	1,250.00	1,423.00	621.28	448.28
247	4/13/50	1/31/52	1,223.00	1,382.50	603.43	441.13
256	4/25/50	1/31/52	1,258.00	1,382.30	603.43	459.11
254	3/ 3/50	1/31/52	1,375.00	1,555.54	713.02	532.48
257	3/ 3/50	1/31/52	1,208.00	1,600.01	732.73	370.72
252	8/23/50	1/31/52	1,325.00	1,546.38	546.87	325.49
266	4/18/50	1/31/52	1,253.00	1,664.75	700.93	349.18
270	4/18/50	1/31/52	1,123.00	1,545.66	675.27	292.61
275	4/25/50	1/31/52	1,325.00	1,578.07	705.36	452.23
278	5/ 9/50	1/31/52	1,300.00	1,570.46	653.47	383.01
279	5/ 9/50	1/31/52	1,250.00	1,582.86	658.44	325.78
294	5/ 9/50	1/31/52	1,350.00	1,545.66	645.23	447.57
287	5/ 9/50	1/31/52	1,200.00	1,570.47	653.43	382.96
288	5/ 9/50	1/31/52	1,263.00	1,570.47	653.43	345.96
293	6/27/50	1/31/52	1,395.00	1,590.16	621.17	423.01
306	5/22/50	1/31/52	1,163.00	1,643.80	751.44	270.64
310	8/23/50	1/31/52	1,350.00	1,548.05	547.15	349.10
314	5/18/50	1/31/52	1,325.00	1,382.32	574.00	547.28
325	6/ 5/50	1/31/52	1,258.00	1,403.32	555.46	410.14
327	6/12/50	1/31/52	1,160.00	1,292.34	510.81	367.47
330	6/12/50	1/31/52	1,275.00	1,421.02	592.64	416.02
331	6/12/50	1/31/52	1,300.00	1,332.38	537.44	495.06
340	6/28/50	1/31/52	1,300.00	1,421.42	561.92	440.50
342	6/28/50	1/31/52	1,238.00	1,403.31	555.46	360.13
372	6/12/50	1/31/52	1,550.00	1,438.29	567.50	679.30
374	6/12/50	1/31/52	1,200.00	1,438.29	567.50	309.30
385	6/28/50	1/31/52	1,228.00	1,378.96	544.44	303.48
390	7/31/50	1/31/52	1,275.00	1,378.53	515.68	412.15

Schedule of long term capital gains, 1952—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
397	8/11/50	1/31/52	\$1,450.00	\$1,421.00	\$502.56	\$528.50
399	8/15/50	1/31/52	1,325.00	1,421.01	501.88	405.87
402	8/15/50	1/31/52	1,325.00	1,421.01	501.88	405.87
405	8/15/50	1/31/52	1,245.00	1,374.85	486.88	369.03
406	9/11/50	1/31/52	1,225.00	1,374.85	486.88	397.03
149	9/11/50	1/31/52	1,495.00	1,507.71	531.82	369.11
420	9/25/50	1/31/52	1,390.00	1,598.17	522.90	254.43
430	8/21/50	1/31/52	1,300.00	1,503.21	532.44	329.23
433	8/21/50	1/31/52	1,300.00	1,503.21	532.44	329.23
435	4/21/50	1/31/52	1,275.00	1,503.21	532.44	304.23
439	8/21/50	1/31/52	1,400.00	1,503.21	532.44	429.23
440	8/21/50	1/31/52	1,275.00	1,503.21	532.44	304.23
442	11/10/50	1/31/52	1,375.00	1,605.19	494.84	264.05
443	9/22/50	1/31/52	1,275.00	1,630.13	558.12	168.99
451	9/25/50	1/31/52	1,250.00	1,608.00	565.40	118.40
487	3/23/51	1/31/52	1,730.00	1,897.25	387.35	220.13
478	2/1/51	1/31/52	1,140.97	1,440.97	300.00	
(Week)						
121	4/2/51	2/29/52	1,600.00	1,506.79	312.90	407.11
125	4/2/51	2/29/52	1,192.89	1,506.79	312.90	
(Week)						
129	4/2/51	2/29/52	1,600.00	1,544.31	321.70	377.39
135	4/2/51	2/29/52	1,600.00	1,544.31	321.70	377.39
219	12/2/49	2/29/52	975.00	1,483.95	803.92	222.77
305	3/22/50	2/29/52	1,275.00	1,506.98	764.33	442.35
321	3/7/50	2/29/52	1,220.00	1,374.85	573.06	448.75
341	6/28/50	2/29/52	1,275.00	1,421.43	591.00	445.17
345	6/28/50	2/29/52	1,275.00	1,378.96	573.20	409.27
355	5/10/50	2/29/52	1,325.00	1,408.78	615.09	531.36
376	6/16/50	2/29/52	1,225.00	1,436.20	597.50	389.30
387	6/28/50	2/29/52	1,275.00	1,378.96	572.51	409.00
393	8/4/50	2/29/52	1,250.00	1,423.81	519.99	346.18
400	8/15/50	2/29/52	1,275.00	1,421.01	532.18	386.17
401	8/15/50	2/29/52	1,325.00	1,421.01	531.52	435.51
410	11/10/50	2/29/52	1,350.00	1,423.38	438.98	365.60
418	11/10/50	2/29/52	1,250.00	1,334.88	417.00	332.12
438	8/21/50	2/29/52	1,250.00	1,503.21	563.76	310.55
448	15/10/50	2/29/52	1,325.00	1,614.44	527.68	228.24
452	3/1/51	2/29/52	1,900.00	1,390.22	318.56	428.34
485	3/23/51	2/29/52	1,700.00	1,897.25	427.11	220.86
493	5/10/51	2/29/52	1,625.00	1,532.16	287.28	360.19
411	9/25/51	3/31/52	1,400.00	1,374.85	512.52	540.67
412	10/2/51	3/31/52	1,400.00	1,423.89	492.48	408.67
413	9/22/51	3/31/52	1,475.00	1,751.63	656.82	380.19
101	5/11/51	5/31/52	1,550.00	1,729.49	431.04	357.55
107	4/30/51	5/31/52	1,550.00	1,897.17	504.46	157.29
131	4/2/51	5/31/52	1,500.00	1,544.31	418.21	373.90
447	5/10/51	5/31/52	1,500.00	1,694.64	373.68	370.94
148	5/10/51	5/31/52	1,550.00	1,532.16	383.04	400.88
149	5/10/51	5/31/52	1,550.00	1,547.08	386.76	389.68
344	6/28/50	5/31/52	1,250.00	1,378.96	650.48	530.52
377	6/16/50	5/31/52	1,250.00	1,438.20	597.50	409.30
419	11/10/50	5/31/52	1,250.00	1,334.88	500.40	415.52
427	11/10/50	5/31/52	1,250.00	1,532.82	565.78	312.96
447	9/22/51	5/31/52	1,200.00	1,608.00	708.00	210.00
440	9/22/50	5/31/52	1,275.00	1,705.32	704.38	274.06
150	3/1/51	5/31/52	1,500.00	1,390.22	405.44	515.23
454	3/1/51	5/31/52	1,475.00	1,390.22	405.44	490.22
460	3/1/51	5/31/52	1,475.00	1,405.13	409.78	479.65

Schedule of long term capital gains, 1952—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
469	3/1/51	5/31/52	\$1,475.00	\$1,426.06	\$415.94	\$464.88
471	3/1/51	5/31/52	1,500.00	1,426.06	415.94	469.88
473	3/1/51	5/31/52	1,475.00	1,426.06	415.94	464.88
497	5/10/51	5/31/52	1,600.00	1,494.64	373.68	509.04
103	5/11/51	6/30/52	1,600.00	1,752.78	474.76	321.98
120	4/2/51	6/30/52	1,500.00	1,506.79	439.46	432.67
124	4/2/51	6/30/52	1,450.00	1,506.79	439.46	282.67
134	4/2/51	6/30/52	1,550.00	1,544.31	450.38	456.07
138	4/2/51	6/30/52	1,550.00	1,544.31	450.38	456.07
139	4/2/51	6/30/52	1,575.00	1,544.31	450.38	481.07
140	4/2/51	6/30/52	1,500.00	1,544.31	450.38	496.07
251	6/27/50	6/30/52	1,250.00	1,606.69	102.94	446.23
296	8/11/50	6/30/52	1,275.00	1,421.40	550.66	504.66
398	8/11/50	6/30/52	1,250.00	1,421.73	650.09	479.07
404	8/15/50	6/30/52	1,250.00	1,421.01	650.08	479.07
417	11/10/50	6/30/52	1,225.00	1,427.73	559.92	357.19
450	3/1/51	6/30/52	1,300.00	1,390.22	434.40	394.18
456	3/1/51	6/30/52	1,450.00	1,390.22	434.40	464.18
459	3/1/51	6/30/52	1,500.00	1,405.13	439.05	533.92
461	3/1/51	6/30/52	1,475.00	1,426.06	445.65	494.69
463	3/1/51	6/30/52	1,350.00	1,426.06	445.65	369.59
466	3/1/51	6/30/52	1,450.00	1,426.06	445.65	469.89
474	3/1/51	6/30/52	1,400.00	1,446.94	452.10	405.16
479	3/1/51	6/30/52	1,450.00	1,440.97	450.00	459.03
480	3/1/51	6/30/52	1,450.00	1,440.97	450.00	459.03
481	3/23/51	6/30/52	1,675.00	1,897.25	586.03	363.78
499	3/23/51	6/30/52	1,700.00	1,904.33	580.57	376.24
225	4/29/52	7/31/52	1,727.01	1,842.12	115.11	
(wreck)						
311	9/11/50	7/31/52	1,300.00	1,511.81	692.13	480.32
394	8/4/50	7/31/52	1,250.00	1,421.00	690.28	506.28
477	3/1/51	7/31/52	1,495.00	1,440.97	480.00	534.03
415	11/10/51	8/31/52	1,250.00	1,373.00	601.02	478.02
482	3/23/51	8/31/52	1,650.00	1,920.57	673.47	402.90
486	8/23/51	8/31/52	1,650.00	1,806.49	655.31	418.83
590	3/23/51	8/31/52	1,650.00	1,904.33	662.18	407.83
115	3/28/51	9/30/52	1,525.00	1,544.31	579.06	559.75
117	3/28/51	9/30/52	1,550.00	1,544.31	579.06	584.75
119	3/28/51	9/30/52	1,525.00	1,544.31	579.06	559.75
128	4/2/51	9/30/52	1,625.00	1,544.31	546.89	527.58
141	4/2/51	9/30/52	1,550.00	1,544.31	546.89	552.58
472	3/1/51	9/30/52	1,485.00	1,426.06	534.75	593.72
494	5/10/51	9/30/52	1,525.00	1,494.64	498.24	528.60
498	5/10/51	9/30/52	1,525.00	1,494.64	498.24	528.60
500	5/10/51	9/30/52	1,525.00	1,547.08	515.68	493.60
151-108	3/28/51	10/31/52	1,500.00	1,506.79	596.41	599.62
109	3/28/51	10/31/52	1,500.00	1,506.79	596.41	589.62
110	3/28/51	10/31/52	1,500.00	1,506.79	596.41	589.62
112	3/28/51	10/31/52	1,475.00	1,544.31	611.23	541.92
113	3/28/51	10/31/52	1,500.00	1,544.31	611.23	566.92
114	3/28/51	10/31/52	1,500.00	1,544.31	611.23	566.92
130	4/2/51	10/31/52	1,500.00	1,544.31	579.06	534.75
132	4/2/51	10/31/52	1,500.00	1,544.31	579.06	534.75
142	4/2/51	10/31/52	1,500.00	1,544.31	579.06	534.75
143	5/10/51	10/31/52	1,475.00	1,547.08	547.91	475.83
145	5/10/51	10/31/52	1,475.00	1,547.08	547.91	475.83
256	3/3/50	10/31/52	1,250.00	1,505.37	914.21	718.84
264	6/28/50	10/31/52	1,250.00	1,378.95	803.28	674.33
303	9/15/53	10/31/52	1,250.00	1,421.01	768.64	507.63

Schedule of long term capital gains, 1952—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprac.	Gain
465	3/ 1/51	10/31/52	\$1,450.00	\$1,390.22	\$330.24	\$610.02
470	3/ 1/51	10/31/52	1,450.00	1,426.06	564.49	588.42
475	3/ 1/51	10/31/52	1,450.00	1,426.06	564.49	588.43
483	3/23/51	10/31/52	1,600.00	1,897.43	743.10	445.67
492	5/ 1/51	10/31/52	1,575.00	1,555.50	548.05	567.55
493	5/10/51	10/31/52	1,500.00	1,547.08	547.91	600.83
133	4/ 2/51	11/30/52	1,475.00	1,544.31	671.23	541.92
136	4/ 2/51	11/30/52	985.25	1,544.31	611.23	32.17
175	12/28/51	11/30/52	1,600.00	1,960.16	447.36	87.20
179	12/28/51	11/30/52	1,600.00	1,960.16	447.36	87.20
274	6/13/52	12/31/52	1,617.57	1,846.75	229.18	
285	6/30/52	12/31/52	1,616.89	1,846.47	229.88	
102	5/11/51	12/31/52	1,400.00	1,759.94	606.54	336.00
106	4/30/51	12/31/52	1,450.00	1,905.67	784.16	328.49
116	3/28/51	12/31/52	1,400.00	1,544.31	675.57	531.26
118	3/25/51	12/31/52	1,400.00	1,544.31	675.57	531.26
123	9/15/51	12/31/52	1,395.00	1,602.77	500.85	293.08
137	4/ 2/51	12/31/52	1,300.00	1,544.31	643.40	399.09
164	9/30/51	12/31/52	1,400.00	1,684.69	526.35	241.66
170	10/24/51	12/31/52	1,400.00	1,684.69	491.40	306.71
193	12/ 6/51	12/31/52	1,400.00	1,772.59	441.64	69.05
195	12/ 6/51	12/31/52	1,400.00	1,796.75	444.02	57.27
203	12/26/51	12/31/52	1,400.00	1,545.69	433.71	88.02
215	3/30/52	12/31/52	2,200.00	1,885.03	353.43	668.40
457	3/ 1/51	12/31/52	1,250.00	1,300.22	606.16	467.94
458	3/ 1/51	12/31/52	1,250.00	1,405.13	614.67	459.54
462	3/ 1/51	12/31/52	1,300.00	1,426.06	623.91	497.85
464	3/ 1/51	12/31/52	1,250.00	1,426.06	623.91	497.85
465	3/ 1/51	12/31/52	1,250.00	1,426.06	623.91	447.85
467	3/ 1/51	12/31/52	1,250.00	1,426.06	623.91	447.85
468	3/ 1/51	12/31/52	1,250.00	1,426.06	623.91	447.85
476	3/ 1/51	12/31/52	1,300.00	1,426.06	623.91	497.85
486	7/ 9/51	12/31/52	1,490.00	1,585.13	591.66	374.83
499	5/10/52	12/31/52	1,300.00	1,404.64	591.66	397.02
Total			253,210.28	278,395.08	99,733.69	74,588.89

R. H. EVANS AND JULIA M. EVANS

Schedule of short term capital gains, 1952

Car No.	Date pur.	Date sold	Sale price.	Cost	Déprec.	Gain
278.....	(Wreck)					
	6/13/52	9/30/52	\$1,516.68	\$1,617.78	\$101.10	
310.....	7/17/52	9/30/52	2,273.99	2,372.85	98.86	
312.....	7/17/52	9/30/52	2,273.99	2,372.85	98.86	
313.....	7/17/52	9/30/52	2,273.99	2,372.85	98.86	
314.....	7/17/52	9/30/52	2,273.99	2,372.85	98.86	
315.....	7/17/52	9/30/52	2,273.99	2,372.85	98.86	
286.....	8/ 6/52	12/31/52	1,610.85	1,757.29	146.44	
290.....	10/29/52	12/31/52	1,613.76	1,693.92	70.16	
294.....	10/29/52	12/31/52	1,645.35	1,716.19	70.84	
296.....	9/30/52	12/31/52	1,767.65	1,885.49	117.84	
297.....	10/29/52	12/31/52	1,613.76	1,693.92	70.16	
298.....	10/29/52	12/31/52	1,645.35	1,716.19	70.84	
418.....	9/30/52	12/31/52	1,850.73	1,974.09	123.36	
419.....	9/30/52	12/31/52	1,825.69	1,947.40	121.71	
420.....	9/30/52	12/31/52	1,825.69	1,947.40	121.71	
426.....	9/30/52	12/31/52	1,840.20	1,962.90	122.70	
Total.....			30,125.66	31,756.82	1,631.16	

Respondent's Exhibit E

R. H. EVANS AND JULIA M. EVANS

Schedule of short term capital gains, 1953

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
118	4/ 1/53	7/31/53	\$1,800.00	\$1,775.16	\$110.94	\$135.78
115	4/ 1/53	7/31/53	1,800.00	1,819.44	113.16	402.72
362	7/15/53	7/31/53	1,785.37	1,785.37		
366	7/15/53	7/31/53	2,150.00	1,896.61		253.39
116	4/ 1/53	8/31/53	1,800.00	1,810.44	11.88	140.44
117	4/ 1/53	8/31/53	1,800.00	1,783.76	16.64	164.88
610-A	7/16/53	8/31/53	2,135.00	1,900.00	39.58	274.88
709-A	6/24/53	8/31/53	1,845.15	1,845.15	76.90	76.90
183	5/18/53	9/30/53	1,800.00	1,793.28	149.44	156.16
199	4/20/53	9/30/53	1,550.00	1,872.17	195.00	127.17
214	5/13/53	9/30/53	1,800.00	1,877.77	156.48	78.71
223	6/ 3/53	9/30/53	1,800.00	1,721.83	107.61	185.78
606	4/ 2/53	9/30/53	1,975.00	2,180.39	227.10	21.71
612	9/15/53	9/30/53	2,150.00	1,945.14		204.86
201	6/ 3/53	10/31/53	1,600.00	1,721.83	143.48	21.05
215	5/13/53	10/31/53	1,600.00	1,877.77	195.60	82.17
216	5/18/53	10/31/53	1,585.00	1,877.77	195.60	97.17
218	6/19/53	10/31/53	1,600.00	1,748.69	145.72	2.97
221	5/13/53	10/31/53	1,600.00	1,877.77	195.60	82.17
289	5/28/53	10/31/53	1,618.75	1,877.77	195.60	63.42
348	5/28/53	10/31/53	1,400.00	2,032.62	211.70	170.92
375	6/12/53	10/31/53	1,640.75	2,032.62	169.40	222.47
380	6/ 3/53	10/31/53	1,600.00	1,732.20	144.32	12.12
713	7/16/53	10/31/53	1,600.00	1,721.83	107.61	14.22
734	6/24/53	10/31/53	1,650.00	1,798.83	149.88	1.05
757	8/11/53	10/31/53	1,675.00	1,812.64	75.52	62.12
759	8/11/53	10/31/53	1,600.00	1,701.61	70.90	30.74
806	8/27/53	10/31/53	2,000.00	1,938.77	80.78	142.01
810	9/15/53	11/30/53	2,025.00	1,945.11	81.04	160.92
700	6/24/53	11/30/53	1,625.00	1,732.20	180.40	73.20
706	6/24/53	11/30/53	1,600.00	1,649.70	171.85	122.15
735	6/24/53	11/30/53	1,650.00	1,798.83	187.35	38.52
773	8/24/53	11/30/53	1,800.00	1,810.04	113.18	103.09
788	8/11/53	11/30/53	1,625.00	1,697.39	100.47	118.08
861	10/20/53	11/30/53	1,937.00	1,787.45	37.24	186.79
758	8/11/53	12/31/53	1,700.00	1,814.80	151.24	36.44
837	7/22/53	12/31/53	1,675.00	1,736.49	180.85	19.36
Total			64,747.02	67,632.21	4,761.01	1,874.82

Schedule of long term capital gains, 1953

Car No.	Date acq.	Date sold	Sale price	Cost	Depr.	Gain
104	4/ 3/51	1/31/53	\$1,375.00	\$1,897.18	\$829.16	\$306.98
111	3/28/51	1/31/53	1,300.00	1,506.79	690.58	483.79
114	9/15/51	1/31/53	1,450.00	602.77	534.24	381.47
156	7/ 9/51	1/31/53	1,500.00	1,690.25	632.60	442.35
152	7/27/51	1/31/53	1,375.00	1,587.01	595.08	383.07
155	9/20/51	1/31/53	1,375.00	1,674.39	558.08	258.69
162	9/20/51	1/31/53	1,375.00	1,674.39	558.08	258.69
166	9/20/51	1/31/53	1,375.00	1,674.39	558.08	258.69
197	1/ 8/52	1/31/53	1,374.00	1,739.02	427.60	62.58
198	12/26/51	1/31/53	1,300.00	1,714.72	464.36	49.64
201	12/20/51	1/31/53	1,326.00	1,752.47	471.86	45.39
208	3/ 3/52	1/31/53	1,775.00	1,919.00	400.00	255.20
307	3/22/50	1/31/53	1,000.00	1,598.03	1,131.29	533.26
122	9/15/51	2/28/53	1,350.00	1,602.77	567.63	314.46
151	7/27/51	2/28/53	1,250.00	1,587.01	628.14	291.13
153	9/20/51	2/28/53	1,350.00	1,602.77	567.63	314.46
156	9/20/51	2/28/53	1,350.00	1,674.39	592.96	268.67
159	9/20/51	2/28/53	1,350.00	1,920.80	673.09	102.29
164	9/20/51	2/28/53	1,400.00	1,674.39	592.96	318.57
173	12/20/51	2/28/53	1,350.00	1,800.06	522.43	72.28
174	12/26/51	2/28/53	1,325.00	1,752.47	508.44	80.97
176	12/26/51	2/28/53	1,350.00	1,756.38	509.69	103.31
181	12/26/51	2/28/53	1,325.00	1,713.46	496.16	107.70
189	1/ 8/52	2/28/53	1,275.00	1,561.85	447.98	61.13
190	12/ 6/51	2/28/53	1,300.00	1,732.12	505.12	73.00
192	12/ 6/51	2/28/53	1,575.00	1,786.75	528.62	106.87
200	12/26/51	2/28/53	1,275.00	1,705.97	497.56	66.69
202	12/26/51	2/28/53	1,350.00	1,690.35	493.08	152.73
204	12/26/51	2/28/53	1,350.00	1,789.22	519.21	79.99
207	12/26/50	2/28/53	1,350.00	1,789.32	519.21	79.89
212	3/ 3/52	2/28/53	1,775.00	1,926.79	441.32	289.53
221	3/31/52	2/28/53	1,675.00	1,636.49	374.99	413.50
302	4/22/52	2/28/53	1,600.00	1,733.47	359.12	225.65
304	4/22/52	2/28/53	1,700.00	1,753.37	365.30	311.93
409	9/11/50	2/28/53	1,100.00	1,387.27	835.36	548.09
127	9/15/51	3/31/53	1,300.00	1,602.77	601.02	298.25
157	9/20/51	3/31/53	1,325.00	1,674.39	627.84	278.45
165	9/20/51	3/31/53	1,250.00	1,684.69	631.62	196.93
167	9/20/51	3/31/53	1,300.00	1,674.39	627.84	253.45
168	9/20/51	3/31/53	1,450.00	1,674.39	627.84	403.45
171	10/24/51	3/31/53	1,300.00	1,684.69	596.70	212.01
172	12/26/51	3/31/53	1,325.00	1,799.91	559.89	84.98
177	12/26/51	3/31/53	1,425.00	1,961.85	610.56	73.71
178	12/26/51	3/31/53	1,250.00	1,798.37	590.46	12.09
180	12/26/51	3/31/53	1,300.00	1,700.84	558.25	67.41
184	12/19/51	3/31/53	1,250.00	1,703.71	538.93	85.22
185	1/ 8/52	3/31/53	1,300.00	1,705.58	496.40	90.82
187	12/19/51	3/31/53	1,350.00	1,654.16	517.05	212.89
188	1/ 8/52	3/31/53	1,250.00	1,652.78	481.00	78.22
191	12/ 6/51	3/31/53	1,300.00	1,774.15	551.48	77.33
196	12/19/51	3/31/53	1,325.00	1,747.89	545.04	122.15
206	12/26/51	3/31/53	1,425.00	1,905.00	609.66	75.63
1004	12/26/51	3/31/53	1,425.00	1,905.45	615.45	71.00
160	9/20/51	4/30/53	1,250.00	1,674.39	662.72	238.33
161	9/20/51	4/30/53	1,400.00	1,684.69	666.71	382.92
183	12/19/51	4/30/53	1,200.00	1,648.91	548.96	100.07
186	1/ 8/52	4/30/53	1,200.00	1,648.91	518.85	69.94

Schedule of long term capital gains, 1953—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
199	12/26/51	4/30/53	\$11,250.00	\$1,705.97	\$568.64	\$112.67
210	3/ 3/52	4/30/53	1,680.00	1,919.80	520.00	260.20
211	3/ 3/52	4/30/53	1,680.00	1,926.79	521.56	244.77
214	3/20/52	4/30/53	1,650.00	1,885.03	510.51	276.42
216	3/20/52	4/30/53	1,690.00	1,885.63	510.51	225.48
222	3/31/52	4/30/53	1,550.00	1,721.85	466.31	294.46
227	4/25/52	4/30/53	1,550.00	1,842.12	460.44	168.32
262	5/21/52	4/30/53	1,550.00	1,648.65	376.18	277.53
400	7/17/52	4/30/53	1,650.00	1,940.92	363.10	72.18
401	5/ 1/51	4/30/53	1,375.00	1,553.89	745.59	566.70
158	9/20/51	5/31/53	1,275.00	1,872.92	777.85	179.93
213	3/20/52	5/31/53	1,350.00	1,885.03	549.78	14.75
209	3/ 3/52	5/31/53	1,500.00	1,919.80	560.00	140.20
217	4/10/52	5/31/53	1,630.00	1,885.03	510.51	275.48
223	4/25/52	5/31/53	1,500.00	1,842.12	498.81	156.69
224	4/25/52	5/31/53	1,540.00	1,842.12	498.81	196.69
225	4/25/52	5/31/53	1,630.00	1,851.64	501.28	190.04
228	4/26/52	5/31/53	1,535.00	1,839.55	498.03	193.48
229	4/25/52	5/31/53	1,560.00	1,839.55	498.03	208.48
231	4/26/52	5/31/53	1,500.00	1,539.55	498.03	158.48
234	4/22/52	5/31/53	1,450.00	1,727.46	468.00	190.54
236	4/22/52	5/31/53	1,500.00	1,727.46	468.00	240.54
263	5/21/52	5/31/53	1,475.00	1,645.76	416.22	245.46
266	5/21/52	5/31/53	1,525.00	1,635.32	406.68	296.36
275	6/13/52	5/31/53	1,500.00	1,846.75	421.73	74.64
277	6/30/52	5/31/53	1,575.00	1,882.47	431.42	123.95
303	4/22/52	5/31/53	1,450.00	1,753.37	474.89	171.52
402	7/17/52	5/31/53	1,430.00	1,940.92	403.55	(87.37)
405	7/17/52	5/31/53	1,550.00	1,903.26	395.75	42.49
410	6/30/52	5/31/53	1,400.00	1,863.07	426.15	(36.92)
412	6/30/52	5/31/53	1,450.00	1,824.41	417.35	42.94
169	9/20/51	6/30/53	1,250.00	1,674.39	732.48	308.09
218	3/31/52	6/30/53	1,475.00	1,721.85	538.05	291.20
230	4/25/52	6/30/53	1,500.00	1,839.55	536.34	196.79
237	4/22/52	6/30/53	1,500.00	1,728.85	506.45	277.60
238	4/22/52	6/30/53	1,450.00	1,776.35	518.00	191.65
247	5/ 7/52	6/30/53	1,425.00	1,807.61	488.14	105.53
249	6/30/52	6/30/53	1,500.00	1,862.13	465.60	103.47
252	6/12/52	6/30/53	1,500.00	1,845.02	460.54	115.52
156	6/13/52	6/30/53	1,500.00	1,845.02	460.54	115.52
261	5/21/52	6/30/53	1,400.00	1,639.66	342.54	102.88
272	6/12/52	6/30/53	1,450.00	1,860.41	464.38	53.97
300	4/22/52	6/30/53	1,400.00	1,733.47	503.68	170.21
301	4/22/52	6/30/53	1,350.00	1,733.47	503.68	120.21
358	5/25/50	6/30/53	1,400.00	1,751.93	1,240.25	907.32
401	7/17/52	6/30/53	1,550.00	1,940.92	444.00	53.08
406	7/17/52	6/30/53	1,430.00	1,903.26	435.42	(17.84)
414	6/30/52	6/30/53	1,475.00	1,824.40	455.38	105.98
424	8/20/52	6/30/53	1,600.00	1,913.28	398.50	85.22
103	1/31/53	7/31/53	1,800.00	1,854.39	231.78	177.39
105	1/31/53	7/31/53	1,800.00	1,800.50	219.28	218.78
101	1/31/53	7/31/53	1,800.00	1,806.66	225.84	219.18
182	12/19/51	7/31/53	1,150.00	1,695.03	699.09	124.06
219	3/31/52	7/31/53	1,400.00	1,721.85	581.92	260.07
232	4/25/52	7/31/53	1,425.00	1,839.55	574.65	180.10
233	4/22/52	7/31/53	1,400.00	1,727.46	540.00	212.54
240	5/28/52	7/31/53	1,350.00	1,740.79	506.36	115.57
243	5/ 7/52	7/31/53	1,375.00	1,738.71	507.08	143.37
244	5/ 7/52	7/31/53	1,400.00	1,798.67	524.58	125.91

Schedule of long term capital gains, 1953—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
250	6/13/52	7/31/53	\$1,500.00	\$1,862.13	\$504.27	\$142.14
267	5/21/52	7/31/53	1,500.00	1,898.74	553.70	154.96
268	5/21/52	7/31/53	1,462.50	1,898.74	553.70	117.46
276	6/30/52	7/31/53	1,450.00	1,871.05	506.74	85.69
305	10/27/52	7/31/53	1,450.00	1,704.04	319.50	65.46
308	10/27/52	7/31/53	1,400.00	1,693.76	317.52	23.76
310	9/17/52	7/31/53	1,400.00	1,773.14	369.40	(3.74)
319-A	9/17/52	7/31/53	1,450.00	1,898.86	395.60	(53.26)
328	11/19/52	7/31/53	1,400.00	1,708.36	284.72	(23.64)
338	11/19/52	7/31/53	1,375.00	1,641.58	273.60	7.02
411	6/30/52	7/31/53	1,475.00	1,866.06	504.46	113.40
421	9/30/52	7/31/53	1,500.00	1,947.40	403.70	(41.70)
416	6/30/52	7/31/53	1,500.00	1,824.40	493.41	169.01
423	8/20/52	7/31/53	1,500.00	1,913.26	435.35	25.00
425	9/ 8/52	7/31/53	1,600.00	2,003.91	417.50	13.59
437	11/21/52	7/31/53	1,500.00	1,769.94	299.92	29.98
438	11/21/52	7/31/53	1,500.00	1,791.08	298.48	7.40
439	11/21/52	7/31/53	1,500.00	1,802.38	300.40	(1.98)
441	11/21/52	7/31/53	1,500.00	1,822.91	303.84	(19.07)
443	11/21/52	7/31/53	1,500.00	1,834.21	305.68	(28.53)
440	11/21/52	7/31/53	1,500.00	1,758.64	293.12	34.48
239	5/28/52	8/31/53	1,325.00	1,684.34	526.56	167.22
241	5/ 7/52	8/31/53	1,300.00	1,778.51	555.75	77.24
242	5/ 7/52	8/31/53	1,375.00	1,769.57	552.90	158.33
246	5/ 6/52	8/31/53	1,300.00	1,798.66	560.80	62.14
271-A	5/21/52	8/31/53	1,450.00	1,888.30	590.10	151.80
273	6/13/52	8/31/53	1,362.50	1,842.13	536.00	56.37
287-A	5/ 6/52	8/31/53	1,425.00	2,007.36	501.84	(80.52)
295	9/30/52	8/31/53	1,350.00	1,757.29	492.71	(4.58)
325	10/27/52	8/31/53	1,325.00	1,589.26	524.85	60.59
327-A	11/19/52	8/31/53	1,425.00	1,743.40	326.88	8.48
331-A	11/19/52	8/31/53	1,425.00	1,803.10	333.03	(45.07)
157 333	11/19/52	8/31/53	1,400.00	1,638.25	302.13	63.88
336	11/19/52	8/31/53	1,400.00	1,732.76	324.90	(7.86)
337	11/19/52	8/31/53	1,350.00	1,641.58	307.80	16.22
429	12/29/52	8/31/53	1,700.00	1,845.74	307.60	161.86
336	11/21/52	8/31/53	1,400.00	1,720.87	322.65	1.78
264	5/21/52	8/31/53	1,300.00	1,672.36	521.20	148.84
282	6/30/52	8/31/53	1,350.00	1,842.13	536.00	43.87
460	1/ 9/53	8/31/53	1,800.00	1,833.63	267.40	233.77
470	2/ 2/53	8/31/53	1,800.00	1,824.07	228.00	203.93
153	3/ 2/53	9/30/53	1,800.00	1,902.19	236.87	134.68
245	5/ 2/52	9/30/53	1,175.00	1,840.88	612.30	(53.58)
248	5/ 7/52	9/30/53	1,400.00	1,813.73	603.26	189.53
269	5/21/52	9/30/53	1,450.00	1,888.30	629.44	191.14
270	5/21/52	9/30/53	1,250.00	1,888.30	629.44	(8.86)
279	6/13/53	9/30/53	1,250.00	1,812.91	566.55	3.64
281	6/30/52	9/30/53	1,250.00	1,766.17	551.85	35.68
288	8/ 6/52	9/30/53	1,450.00	2,007.26	543.66	(13.70)
292	9/30/52	9/30/53	1,300.00	1,855.62	463.92	(91.70)
335	11/19/52	9/30/53	1,350.00	1,643.78	342.40	48.65
464	2/ 3/53	9/30/52	1,700.00	1,928.65	277.76	49.11
472	2/ 2/53	9/30/52	1,625.00	1,824.07	266.00	66.93
486	3/23/51	9/30/53	1,150.00	1,827.20	1,181.98	434.72
112	4/ 1/53	10/31/53	1,425.00	1,698.57	212.34	(61.23)
113	4/ 1/53	10/31/53	1,495.00	1,712.42	214.20	(4.22)
154	3/ 2/53	10/31/53	1,600.00	1,868.31	275.25	(18.06)
263	4/29/53	10/31/53	1,600.00	1,767.25	233.40	(33.85)
264	4/29/53	10/31/53	1,600.00	1,867.25	233.40	(33.85)

Schedule of long term capital gains, 1953—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec.	Gain
220	3/31/52	10/31/53	\$1,075.00	\$1,588.99	\$631.66	\$117.67
233	4/22/52	10/31/53	1,150.00	1,727.46	648.00	70.54
254	5/20/52	10/31/53	1,975.00	1,673.97	592.79	(6.18)
257	5/20/52	10/31/53	1,150.00	1,673.97	592.79	68.82
280	6/30/52	10/31/53	1,284.00	1,800.45	598.92	62.47
292	9/30/52	10/31/53	1,150.00	1,757.29	588.76	(21.53)
293	9/30/52	10/31/53	1,300.00	1,855.62	592.58	(53.04)
318	9/17/52	10/31/53	1,075.00	1,649.74	446.81	(127.93)
339	11/19/52	10/31/53	1,200.00	1,595.09	365.53	(29.56)
413	6/30/52	10/31/53	1,200.00	1,824.40	607.50	(16.90)
435	11/21/52	10/31/53	1,275.00	1,720.87	394.35	(51.52)
449	3/23/53	10/31/53	1,125.00	1,824.04	266.00	(433.04)
454	3/ 2/53	10/31/53	1,550.00	1,807.66	263.62	5.96
466	2/ 2/53	10/31/53	1,550.00	1,807.38	301.20	43.82
468	2/ 3/53	10/31/53	1,550.00	1,807.38	301.20	43.82
473	2/16/53	10/31/53	1,550.00	1,844.27	300.84	6.57
474	2/16/53	10/31/53	1,575.00	1,803.71	296.89	68.18
478	3/ 2/53	10/31/53	1,550.00	1,807.66	263.62	5.96
489	3/ 2/53	10/31/53	1,600.00	1,807.66	263.62	55.96
602	4/ 2/53	10/31/53	1,975.00	2,180.39	272.52	67.13
605	4/ 2/53	10/31/53	1,975.00	2,180.39	272.52	67.13
607	4/ 2/53	10/31/53	1,975.00	2,180.39	272.52	67.13
102	1/31/53	11/30/53	1,423.69	1,792.77	369.08	
106	1/31/53	11/30/53	1,400.00	1,785.36	372.00	(13.36)
109	4/ 1/53	11/30/53	1,000.00	1,713.42	249.90	136.48
153	4/ 1/53	11/30/53	1,450.00	1,733.23	252.70	(30.53)
166	4/ 8/53	11/30/53	1,600.00	1,830.41	266.91	36.59
174	4/ 8/53	11/30/53	1,550.00	1,830.41	266.91	(13.50)
179	4/ 8/53	11/30/53	1,600.00	1,830.41	266.91	36.50
192	4/ 8/53	11/30/53	1,575.00	1,830.41	266.91	11.50
200	4/29/53	11/30/53	1,600.00	1,872.17	273.00	.83
278	5/28/53	11/30/53	1,625.00	1,877.77	234.72	(18.05)
291	5/28/53	11/30/53	1,600.00	1,869.71	233.70	(36.01)
347	5/28/53	11/30/53	1,650.00	2,032.69	254.04	(128.58)
453	12/ 3/53	11/30/53	1,525.00	1,944.06	364.50	(54.56)
475	2/16/53	11/30/53	1,550.00	1,844.37	339.42	45.05
483	3/ 2/53	11/30/53	1,575.00	1,807.66	301.28	68.62
167	6/12/53	12/31/53	1,600.00	1,752.21	212.29	66.79
258	3/ 3/50	12/31/53	750.00	1,806.61	1,412.29	652.68
304	5/18/53	12/31/53	1,600.00	1,877.77	273.84	(3.93)
323	10/27/52	12/31/53	1,125.00	1,687.70	456.32	(5.78)
361	5/28/52	12/31/53	1,600.00	1,786.91	260.61	73.70
379	6/ 3/53	12/31/53	1,650.00	1,732.20	216.48	134.28
382	6/ 3/53	12/31/53	1,550.00	1,792.00	223.98	(18.02)
465	2/ 3/53	12/31/53	1,575.00	1,807.38	376.50	144.12
469	2/ 3/53	12/31/53	1,550.00	1,807.38	376.50	119.12
482	3/ 2/53	12/31/53	1,575.00	1,807.66	338.94	106.28
492	5/ 7/53	12/31/53	1,700.00	2,119.66	309.12	(110.54)
601	3/24/53	12/31/53	2,400.00	2,578.62	483.48	304.86
603	4/ 2/53	12/31/53	2,000.00	2,180.39	363.36	182.97
813	6/29/53	12/31/53	1,600.00	1,790.23	223.80	33.57
817	6/29/53	12/31/53	1,575.00	1,790.23	223.80	8.57
Total			328,607.69	406,638.81	106,143.13	27,112.01

Respondent's Exhibit F

R. H. EVANS AND JULIA M. EVANS

Schedule of short-term capital gains, 1954

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec. St. Line method	Deprec. declining bal. method	Gain-or loss
100-A	11/24/54	12/ 2/54	\$2,600.00	\$2,211.84			\$388.16
102	12/15/53	1/ 5/54	1,850.00	1,666.50	\$34.72		218.22
202-A	5/25/54	11/ 2/54	1,650.00	1,827.82		\$280.80	202.98
204-A	6/ 5/54	11/16/54	1,750.00	1,858.58		387.40	278.82
205-A	5/29/54	11/ 2/54	1,650.00	1,845.50		384.50	188.91
240-A	6/15/54	11/ 2/54	1,600.00	1,704.21		355.00	250.79
241-A	6/15/54	11/22/54	1,650.00	1,760.88		366.80	255.92
245-A	6/15/54	11/20/54	1,650.00	1,760.88		366.80	255.92
442-RW	4/ 8/54	6/ 8/54	2,695.00	2,490.39		207.62	412.13
443-RW	4/ 8/54	9/29/54	2,000.00	1,963.32		409.00	445.68
475-A	6/16/54	11/15/54	1,600.00	1,866.00		388.80	122.80
614-RW	2/10/54	3/10/54	2,350.00	1,966.81		77.78	466.97
615-RW	2/10/54	4/ 5/54	2,150.00	1,824.06		152.04	477.38
618-RW	3/ 4/54	3/19/54	2,210.00	1,908.77			301.23
619-RW	3/ 4/54	3/22/54	2,250.00	1,941.85			308.15
620-RW	3/ 4/54	3/16/54	2,250.00	1,941.85			308.15
624-RW	5/22/54	6/16/54	2,191.07	2,037.28			153.79
625-RW	6/15/54	8/30/54	2,020.00	1,845.87		230.76	404.80
628-C	5/29/54	11/ 5/54	2,000.00	2,112.82		440.20	327.38
630-RW	5/11/54	8/26/54	2,125.00	1,942.12		242.76	425.64
631-P	5/19/54	9/14/54	2,175.00	2,106.00		350.00	425.00
632-P	5/19/54	10/ 5/54	2,100.00	2,100.00		437.50	437.50
634-RW	6/21/54	7/27/54	2,200.00	1,870.51		77.94	407.43
717-A	8/11/53	1/ 7/54	1,650.00	1,857.92	193.55		14.37
722-A	7/31/53	1/ 8/54	1,650.00	1,857.92	193.55		14.37
764	7/24/53	1/12/54	1,575.00	1,693.73	176.45		57.72
777-A	8/ 7/53	1/ 6/54	1,675.00	1,857.92	193.55		10.63
792	8/11/53	1/15/54	1,575.00	1,619.34	168.65		124.31
796-A	8/10/53	1/ 6/54	1,850.00	1,774.44	184.85		90.41
808-A	9/ 9/53	2/23/54	1,675.00	1,989.10	207.20		106.90
876	6/ 3/54	11/ 2/54	1,500.00	1,615.32		332.84	217.52
889	6/16/54	11/ 2/54	1,600.00	1,866.00		388.80	422.80
937	5/14/54	9/30/54	1,562.22	1,701.58	140.36	Charged to E.U.D.R. Co., total wreck	
943-A	6/29/54	12/20/54	1,625.00	1,696.11		353.30	282.19
946-A	6/24/54	12/10/54	1,625.00	1,640.45		410.16	394.71
947-A	6/24/54	12/ 2/54	1,615.00	1,677.15		419.28	357.13
959	6/30/54	12/14/54	1,500.00	1,493.16		309.56	316.40
960P	6/30/54	11/ 2/54	1,500.00	1,491.78		243.86	252.08
973-A	6/11/54	12/10/54	1,625.00	1,716.07		429.00	337.93
986-A	6/14/54	11/ 3/54	1,650.00	1,650.45		343.80	343.35
987-A	6/14/54	10/22/54	1,735.00	1,680.83		277.72	331.99
989	6/14/54	11/ 1/54	1,675.00	1,689.45		348.00	334.45
250	6/21/54	12/17/54	1,384.09	1,495.81	218.12	Chgd. E.U.D.R. Co. stolen	106.40
Total			78,761.38	78,613.08	1,711.00	9,112.82	10,972.12

R. H. EVANS AND JULIA M. EVANS
Schedule of long term capital gains, 1954

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec. St. line method	Deprec. declining bal. method	Gain or loss
100	12/ 8/53	11/ 9/54	\$1,375.00	\$1,666.50	\$381.92		\$95.42
101	12/ 8/53	6/30/54	1,600.00	1,666.50	208.32		141.68
103	12/15/53	9/23/54	1,500.00	1,666.50	312.48		145.96
104	12/15/53	9/23/54	1,500.00	1,666.50	312.48		145.96
106	12/16/53	9/24/54	1,475.00	1,666.50	347.20		155.70
107	1/24/54	4/15/54	1,350.00	1,785.36	558.00		122.64
108	4/ 1/53	3/ 3/54	1,367.40	1,696.57	329.29		58.12
114	3/19/53	8/ 6/54	1,175.00	1,759.90	586.40		2.40
151	2/20/53	7/ 7/54	1,251.99	1,851.55	616.31		13.76
162	2/20/53	6/17/54	1,350.00	1,860.42	580.58		70.15
155	3/17/53	10/11/54	1,225.00	1,830.39	686.34		80.95
156	4/ 8/53	5/17/54	1,300.00	1,712.29	463.71		51.42
159	3/24/53	10/19/54	1,225.00	1,830.41	686.34		80.95
160	6/ 5/53	12/ 6/54	1,150.00	1,694.18	635.22		91.04
161	6/ 5/53	1/25/54	1,575.00	1,694.18	247.63		127.95
164	3/23/53	10/11/54	1,150.00	1,705.26	639.54		84.26
166	3/30/53	5/17/54	1,400.00	1,830.41	495.69		65.25
170	3/30/53	8/11/54	1,300.00	1,830.41	610.08		79.67
173	3/30/53	7/ 7/54	1,280.00	1,830.41	571.95		21.54
175	4/ 8/53	8/24/54	1,375.00	1,830.41	610.08		54.67
176	4/ 4/53	9/10/54	1,250.00	1,830.41	648.21		67.80
181	4/ 4/53	6/25/54	1,300.00	1,776.96	518.28		41.22
186	5/11/53	8/ 2/54	1,300.00	1,732.20	541.20		106.00
188	4/ 4/53	8/10/54	1,175.00	1,776.96	592.32		9.64
189	4/ 7/53	10/ 8/54	1,200.00	1,830.41	686.34		55.95
190	4/ 4/53	8/16/54	1,250.00	1,830.41	610.08		29.67
193	4/ 7/53	9/ 7/54	1,250.00	1,931.27	681.48		21
196	4/ 7/53	7/27/54	1,350.00	1,872.17	585.00		62.83
196	4/ 9/53	3/ 2/54	1,500.00	1,830.41	419.43		89.07
197	4/29/53	2/ 9/54	1,500.00	1,872.17	390.00		17.83
198	6/ 5/53	6/15/54	1,350.00	1,694.18	423.48		79.30
202	7/ 7/53	7/ 7/54	1,345.00	1,867.25	563.10		61.24
205	5/12/54	7/12/54	1,425.00	1,731.70	468.91		162.21
206	3/17/53	8/11/54	1,150.00	1,787.54	595.84		41.70
207-A	3/20/53	9/15/54	1,450.00	2,022.10	716.55		144.45
208	4/24/53	8/ 4/54	1,300.00	1,877.77			9.65
210-A	4/24/53	8/ 4/54	1,400.00	2,032.62			2.62
212	4/24/53	8/ 3/54	1,325.00	1,877.77			34.63
217	5/ 7/53	2/20/54	1,800.00	1,877.77	352.06		25.69
222	5/12/53	7/29/54	1,300.00	1,721.83	466.21		44.46
224	5/26/53	5/17/54	1,425.00	1,721.83	394.57		97.74
225	5/26/53	1/ 6/54	1,575.00	1,732.20	252.56		95.36
227	6/17/53	6/ 2/54	1,425.00	1,721.83	430.44		153.61
227-A	5/11/54	11/19/54	1,650.90	1,769.43		\$439.80	330.37
251-A	6/16/54	12/19/54	1,625.00	1,866.00		466.56	225.56
251	5/ 7/53	5/ 4/54	1,450.00	1,877.77	469.44		41.67
161 255	5/12/53	5/11/54	950.00	1,673.97	836.88		312.91
259	5/15/52	5/ 4/54	950.00	1,689.94	809.83		69.89
260	6/12/52	4/16/54	950.00	1,683.92	771.76		37.84
262	4/15/53	8/ 2/54	1,175.00	1,708.30	532.20		4.00
266-A	5/ 7/53	3/ 8/54	1,575.00	1,906.43	415.90		5.52
299	9/ 2/52	7/ 7/54	1,000.00	1,774.19	913.12		138.93
302-A	5/22/53	9/27/54	1,375.00	2,032.62	635.25		22.37
303-A	5/27/53	9/22/54	1,375.00	2,032.62	635.25		22.37
306	10/18/52	6/ 3/54	1,100.00	1,704.04	710.00		166.96

Schedule of long term capital gains, 1954—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec. St. Line method	Deprec. declining bal. method	Gain or loss
307-A	5/18/53	8/20/54	\$1,450.00	\$2,032.62	\$635.10		\$52.48
308	10/18/52	5/ 4/54	1,100.00	1,603.76	670.32		76.56
311	5/18/53	6/25/54	1,400.00	1,877.77	547.68		69.91
317	9/12/52	3/31/54	1,115.00	1,773.14	664.92		6.78
320	10/24/52	2/ 3/54	950.00	1,538.03	512.20		75.83
321	10/24/52	5/ 4/54	950.00	1,540.20	606.30		19.10
322	10/24/52	2/ 3/54	950.00	1,538.03	512.20		75.83
324	10/24/52	5/ 6/54	950.00	1,538.03	608.35		20.32
330	10/30/52	2/16/54	1,050.00	1,641.21	508.35		82.86
334	10/31/52	4/ 3/54	1,050.00	1,666.06	503.06		43.00
340	11/11/52	5/ 4/54	1,100.00	1,732.76	649.80		17.04
341	11/24/52	2/16/54	950.00	1,494.39	466.95		77.44
342	11/24/52	2/ 2/54	950.00	1,494.39	466.95		77.44
343	11/24/52	6/15/54	900.00	1,494.39	591.47		2.92
345	12/16/52	2/ 2/54	1,050.00	1,657.62	479.94		127.68
346-A	5/22/53	7/12/54	1,475.00	2,032.62	592.76		35.14
350	5/23/53	5/24/54	1,450.00	1,749.36	437.29		137.92
351	5/23/53	8/21/54	1,300.00	1,749.36	546.60		97.24
352	5/23/53	9/10/54	1,225.00	1,749.36	583.04		58.68
354	5/ 9/53	6/ 1/54	1,250.00	1,862.18	503.75		108.43
356	5/25/53	7/ 8/54	1,325.00	1,748.41	510.02		86.61
359	5/23/53	8/11/54	1,350.00	1,794.28	500.70		116.42
360	5/23/53	9/15/54	1,300.00	1,786.91	505.68		108.77
363	7/15/53	3/17/54	1,525.00	1,785.37	297.52		37.15
364	7/15/53	1/18/54	1,575.00	1,785.37	224.14		12.77
367	7/15/53	8/11/54	1,100.00	1,539.90	417.04		22.86
368	7/15/53	9/13/54	1,150.00	1,587.48	417.04		20.44
369-A	6/ 1/53	8/ 4/54	1,400.00	2,032.62	592.90		39.72
371-A	6/ 1/53	8/25/54	1,425.00	2,032.62	592.90		14.72
373-A	6/ 1/53	5/24/54	1,550.00	2,032.62	508.20		25.58
374-A	5/27/53	9/15/54	1,375.00	2,032.62	635.25		22.37
378	5/26/53	4/ 6/54	1,450.00	1,721.53	358.70		86.87
400-RW	3/19/54	11/23/54	2,000.00	2,048.68		\$681.28	637.60
408-A	4/13/54	12/10/54	1,650.00	1,875.49		625.12	399.63
411-A	4/ 3/54	11/30/54	1,625.00	1,923.68		641.28	342.60
413	4/16/54	12/22/54	1,500.00	1,733.39		577.76	344.37
424	5/25/54	12/ 9/54	1,575.00	1,710.73		513.24	328.51
425	4/20/54	11/12/54	1,600.00	1,771.39		516.60	345.21
428	12/22/52	4/28/54	1,300.00	1,845.74	615.20		69.46
430	12/22/52	8/16/54	1,500.00	1,845.74	769.00		23.26
431	12/22/52	6/16/54	1,200.00	1,845.74	692.10		46.36
432	12/22/52	4/30/54	1,350.00	1,845.74	653.65		157.91
433	12/22/52	4/ 6/54	1,350.00	1,845.74	615.20		119.46
434	12/22/52	6/ 1/54	1,250.00	1,845.74	692.10		98.36
435-A	4/20/54	11/4/54	1,700.00	1,913.69		558.18	344.49
444	2/ 5/53	2/24/54	1,400.00	1,938.11	484.56		53.55
444-A	5/11/54	11/15/54	1,600.00	1,886.79		471.72	184.93
445	2/ 5/53	3/24/54	1,400.00	1,929.70	523.60		6.10
445-A	5/11/54	11/2/54	1,625.00	1,886.79		471.72	209.93
446	1/21/53	8/ 3/54	1,200.00	1,845.24	691.92		46.65
447	1/23/53	3/24/54	1,400.00	1,930.91	522.99		7.92
447-A	5/19/54	11/28/54	1,600.00	1,875.49		546.98	271.49
448	1/31/53	6/ 1/54	1,250.00	1,841.97	613.31		21.34
450	2/21/53	9/ 1/54	1,150.00	1,776.54	767.52		140.98
451	2/20/53	8/ 2/54	1,250.00	1,916.27	678.64		12.37
454-A	5/11/54	11/19/54	1,675.00	1,924.79		481.20	231.41
455	2/ 5/53	3/10/54	1,300.00	1,970.35	615.75		54.00

Schedule of long term capital gains, 1953—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec. St. Line method	Deprec. declining bal. method	Gain or loss
456	2/ 5/53	3/ 2/54	\$1,550.00	\$1,970.35	\$533.52		\$113.27
456-A	3/11/54	11/2/54	1,650.00	1,924.79		\$481.20	206.41
457-A	4/29/53	3/ 4/54	1,660.00	2,145.89	447.09		48.89
461	1/22/53	6/ 8/54	1,200.00	1,990.47	533.44		132.97
462	1/22/53	7/16/54	1,125.00	1,660.47	565.78		91.31
463	2/ 3/53	1/ 6/54	1,575.00	1,833.43	420.20		161.77
465	2/ 3/54	12/4/54	1,600.00	1,722.09		502.32	350.33
471	1/22/53	5/17/54	1,410.00	1,824.07	570.00		155.93
476	1/29/53	11/23/54	1,200.00	1,826.33	799.05		172.72
477	4/23/54	11/ 2/54	1,600.00	1,771.39		516.60	345.21
478-A	5/11/54	10/30/54	1,650.00	1,900.22		450.00	298.78
479	2/17/53	8/12/54	1,250.00	1,807.66	640.22		82.56
480	2/17/53	6/ 2/54	1,250.00	1,807.66	640.90		7.21
481	2/17/53	8/24/54	1,250.00	1,807.66	640.22		82.56
482	5/11/54	11/13/54	1,600.00	1,674.42		418.56	344.14
483-A	5/11/54	11/13/54	1,650.00	1,723.93		431.36	357.45
484	2/18/53	6/23/54	1,300.00	1,807.66	602.55		94.20
485	2/17/53	6/ 2/54	1,250.00	1,807.66	640.90		7.21
486	2/17/53	8/10/54	1,150.00	1,807.66	640.22		17.41
487	2/17/53	6/16/54	1,250.00	1,807.66	640.90		7.21
488-A	5/11/54	11/13/54	1,600.00	1,796.21		449.04	252.82
489-A	5/11/54	11/18/54	1,600.00	1,703.50		425.88	322.38
490	4/ 1/53	9/11/54	1,100.00	1,693.10	531.04		37.94
491	3/ 9/53	6/ 1/54	1,250.00	1,871.89	546.00		75.89
495	3/27/53	3/16/54	1,550.00	1,838.77	324.04		15.27
496	3/27/53	6/ 1/54	1,360.00	1,728.15	502.59		74.44
163	3/27/53	6/11/54	1,550.00	1,922.77	558.62		186.86
499	3/ 6/53	4/16/54	1,450.00	1,749.36	400.84		101.48
500	5/ 8/53	9/ 1/54	1,200.00	1,749.36	583.04		33.68
604-P	4/ 1/53	2/12/54	1,850.00	2,180.39	454.24		125.61
616-RW	2/19/54	11/12/54	2,000.00	2,032.71		677.90	644.99
621-O	3/15/54	10/ 5/54	2,400.00	2,390.70		687.62	706.92
701	6/ 6/53	2/ 5/54	1,550.00	1,721.83	286.96		160.13
702	6/ 6/53	2/24/54	1,450.00	1,721.83	322.52		61.00
703	6/ 6/53	7/12/54	1,375.00	1,721.83	400.91		119.45
704	6/ 6/53	6/28/54	1,250.00	1,649.70	446.81		47.11
706	6/ 5/53	8/16/54	1,100.00	1,649.70	515.55		31.15
707	6/24/53	10/11/54	1,325.00	1,893.55	631.29		62.65
708	6/19/53	4/ 5/54	1,550.00	1,731.70	252.56		70.66
710-A	6/18/53	7/16/54	1,475.00	1,894.55	513.11		93.56
712	6/29/53	8/16/54	1,300.00	1,721.83	466.31		44.45
714	6/29/53	3/ 8/54	1,500.00	1,721.83	286.96		65.13
716-A	8/11/53	8/24/54	1,375.00	1,867.92	464.52		18.40
718-A	8/11/53	9/ 8/54	1,400.00	1,857.92	503.23		45.31
719-A	8/11/53	6/23/54	1,525.00	1,867.92	387.10		54.18
720-A	7/31/53	4/20/54	1,600.00	1,857.92	309.68		51.76
721-A	7/31/53	2/ 4/54	1,725.00	1,857.92	232.26		93.34
730	6/18/53	10/13/54	1,150.00	1,614.63	538.24		73.61
737	6/19/53	3/12/54	1,500.00	1,746.31	327.42		81.11
738	6/19/53	5/17/54	1,425.00	1,746.31	400.18		78.57
739	6/19/53	10/22/54	1,175.00	1,668.43	566.08		62.65
740	6/19/53	1/11/54	1,625.00	1,746.31	254.66		133.35
741	6/29/53	2/23/54	1,650.00	1,694.18	247.03		152.85
742	6/24/53	3/ 1/54	1,500.00	1,748.75	291.44		62.69
743-A	7/ 7/53	10/ 1/54	1,300.00	1,759.49	502.35		112.86
745	7/ 7/53	5/19/54	1,400.00	1,628.88	339.30		110.52
746	7/ 7/53	2/ 5/54	1,500.00	1,678.42	244.72		66.20

Schedule of long term capital gains, 1954—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec. St. Line method	Deprec. declining bal. method	Gain or loss
707	7/ 2/53	9/15/54	\$1,275.00	\$1,725.73	\$303.30		\$52.57
708	7/ 2/53	4/ 5/54	1,450.00	1,723.56	323.19		49.63
709	7/16/53	2/11/54	1,575.00	1,737.85	253.40		60.55
710-A	7/16/53	7/ 8/54	1,475.00	1,808.42	474.60		51.18
711-A	7/16/53	9/29/54	1,375.00	1,898.42	553.70		30.26
712-A	7/16/53	6/25/54	1,550.00	1,898.42	474.60		126.18
714	7/16/53	9/22/54	1,275.00	1,737.86	506.80		43.94
715	7/16/53	9/ 2/54	1,275.00	1,737.86	506.80		43.94
716	7/16/53	1/25/54	1,575.00	1,729.98	216.24		61.26
717	7/24/53	2/25/54	1,500.00	1,691.56	235.68		55.12
718	7/24/53	4/ 3/54	1,425.00	1,693.73	252.32		13.80
719	7/24/53	2/24/54	1,500.00	1,691.56	211.44		19.88
720	7/24/53	7/19/54	1,490.00	1,691.56	387.69		96.08
721-A	8/ 7/53	5/28/54	1,325.00	1,810.54	439.39		54.35
722	8/ 8/53	2/15/54	1,575.00	1,641.34	265.02		135.68
723	8/ 7/53	8/ 7/54	1,300.00	1,689.22	422.28		33.06
724-A	8/ 7/53	10/11/54	1,325.00	1,799.59	524.86		49.97
725	8/ 7/53	10/ 8/54	1,300.00	1,647.77	538.86		8.91
726-A	8/ 7/53	10/ 5/54	1,325.00	1,837.92	541.94		9.02
727	8/ 7/53	2/12/54	1,575.00	1,699.57	212.45		88.09
728-A	7/31/53	5/28/54	1,525.00	1,772.32	332.28		84.96
729	7/31/53	7/28/54	1,300.00	1,619.34	371.14		51.80
730	7/31/53	6/25/54	1,300.00	1,619.34	337.40		18.06
731	7/31/53	7/13/54	1,300.00	1,609.51	368.83		50.32
732	7/31/53	8/22/54	1,500.00	1,609.51	334.71		135.20
733	7/31/53	4/23/54	1,450.00	1,619.31	292.92		100.58
734	7/31/53	7/ 8/54	1,500.00	1,617.22	370.59		53.37
735	8/11/53	8/31/54	1,300.00	1,572.99	426.01		153.62
736-A	8/11/53	5/17/54	1,550.00	1,774.44	369.70		145.28
737-A	8/11/53	9/ 7/54	1,350.00	1,754.44	480.51		56.17
738-A	8/10/53	5/10/54	1,550.00	1,765.49	367.20		154.71
739-A	8/10/53	7/15/54	1,475.00	1,764.61	404.36		114.75
740-A	8/10/53	8/14/54	1,400.00	1,764.61	441.12		76.51
741-A	8/26/53	8/10/54	1,250.00	1,751.85	511.00		9.15
742-A	8/13/53	9/ 2/54	1,450.00	1,900.22	511.93		63.71
743-A	8/13/53	4/28/54	1,550.00	1,916.08	319.36		46.72
744-A	8/25/53	6/16/54	1,550.00	1,938.77	403.90		15.13
745-A	8/25/53	12/21/54	1,300.00	1,938.77	546.24		7.47
746	8/31/53	8/10/54	1,350.00	1,790.23	522.20		81.97
747	6/27/53	9/ 3/54	1,300.00	1,720.20	537.60		117.40
748	6/27/53	8/ 2/54	1,300.00	1,787.35	518.15		30.80
749	6/27/53	11/30/54	1,300.00	1,790.23	671.40		81.17
750	6/27/53	6/25/54	1,400.00	1,728.20	430.08		109.88
751	6/27/53	5/18/54	1,425.00	1,790.23	410.30		45.07
752	7/30/53	9/ 5/54	1,150.00	1,615.87	467.33		1.46
753	7/28/53	9/ 2/54	1,175.00	1,736.49	506.38		55.11
754	7/15/53	9/28/54	1,125.00	1,547.86	449.68		32.82
755	7/24/53	12/22/54	1,200.00	1,702.51	591.60		89.09
756	7/24/53	9/22/54	1,300.00	1,744.07	508.62		64.55
757	7/ 7/53	8/ 7/54	1,350.00	1,722.92	466.70		93.78
758	8/27/53	9/22/54	1,200.00	1,739.49	434.88		104.61
759	8/27/53	6/16/54	1,450.00	1,755.90	329.22		33.32
760	8/27/53	7/28/54	1,350.00	1,739.49	398.64		9.15
761	8/27/53	10/20/54	1,280.00	1,673.54	453.18		29.64
762	8/27/53	7/27/54	1,300.00	1,749.35	364.40		84.95
763	9/ 1/53	7/19/54	1,350.00	1,746.67	363.90		32.77
764	10/ 3/53	8/31/54	1,175.00	1,614.83	347.16		7.33

Schedule of long term capital gains, 1954—Continued

Car No.	Date pur.	Date sold	Sale price	Cost	Deprec. St. Line method	Deprec. declining bal. method	Gain or loss
865	10/10/53	12/13/54	\$1,650.00	\$1,998.13	\$382.82		\$234.49
868	1/30/54	11/8/54	1,600.00	1,771.25		\$664.20	492.95
854	8/27/53	5/13/54	1,450.00	1,755.90	292.64		13.26
855	8/27/53	5/27/54	1,450.00	1,755.90	329.22		23.32

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EVANS, 1954

		Sale price	Cost	Depreciation straight line method	Depreciation declining balance method	Gain or loss
			1,649.05		618.30	619.25
			1,627.71		619.38	282.67
			1,771.25		738.00	541.76
			1,739.30		434.88	195.58
			1,739.30		434.88	245.58
			1,739.30		434.88	270.58
			1,892.70		473.16	285.46
			1,867.51		855.80	563.29
			1,693.61		603.20	629.39
			1,768.63		588.30	191.67
			1,768.63		588.30	244.67
		1,300.00	1,817.76		661.66	563.90
		1,615.00	1,669.40		628.04	571.35
		1,500.00	1,554.11		582.64	528.70
		1,615.00	1,723.83		574.56	465.73
	12/8/54	1,615.00	1,723.83		574.56	465.90
	12/15/54	1,475.00	1,520.61		503.08	437.47
	12/10/54	1,500.00	1,560.42		527.00	437.13
4/12/54	11/22/54	1,565.00	1,890.42		461.26	370.84
5/14/54	11/30/54	1,615.00	1,665.47		505.80	455.33
6/14/54	12/26/54	1,600.00	1,608.57		462.12	383.55
6/10/54	12/12/54	1,500.00	1,518.02		379.80	361.18
6/10/54	12/16/54	1,500.00	1,478.86		371.76	394.90
6/5/54	9/3/54	1,000.00	2,346.98	1,907.10		560.12

Total long term	352,083.40	451,286.76	105,281.78	25,366.98	29,365.40
Total short term	78,761.38	78,613.08	1,711.00	9,112.82	10,972.12
Total sales	\$430,764.78	\$529,899.84	\$104,992.78	\$34,479.80	
Total net profit on cars sold					\$40,337.52

CLERK'S NOTE: Counsel have stipulated that the obliterated portions of this exhibit are not pertinent.

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Petitioner's Exhibit 12

Name of asset: 1948 Chevrolet sedan

Acct. No. 705

Manufacturer's serial No.: 6FKG18304.

Size: Motor #FAA400021.

Model: Fleetmaster.

Description: 1948 Chevrolet, 4-door sedan, car and heater.....\$1,732.00

Radio.....33.16

1,765.16

Date acquired	Date installed	Details of purchase and assembly	Posting ref.	Original cost	Credits	Balance
8/31/48		Rothell Chevrolet Co., Inc., Heater.	(1878) ek. 202	\$1,732.00		\$1,732.00
8/30/		S. L. Savidge Radio.	298	33.16		
				1,765.16		1,765.16
	11/30/50	Sold	J112		\$1,765.16	

Depreciation year

	1948	1949	1950
Date determined	\$36.79		
Amount forward		\$183.24	\$624.72
January		36.79	36.79
February		220.03	661.51
March		36.79	36.79
April		256.82	698.30
May		36.79	36.79
June		330.40	771.88
July		36.79	36.79
August	3.608	440.77	662.35
September	36.79	36.79	36.79
October	72.87	477.56	919.04
November	36.79	36.79	36.79
December	109.36	514.35	955.83
Total for year	183.24	624.72	

Copy of original.

R. J. B. 2/4-57.

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In the Supreme Court of the United States

OCTOBER TERM, 1958

No.

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ROBLEY H. EVANS AND JULIA M. EVANS

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE
NINTH CIRCUIT**

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (Appendix A, *infra*, pp. 41-48), are not officially reported. The opinion of the Court of Appeals (Appendix A, *infra*, pp. 15-40) is reported at 264 F. 2d 502.

JURISDICTION

The judgment of the Court of Appeals was entered on January 26, 1959. (Appendix A, *infra*,

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p. 40.) On April 23, 1959, by order of Mr. Justice Douglas, the time within which to petition for certiorari was extended to and including June 25, 1959. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTION PRESENTED

The taxpayer is in the business of leasing automobiles to a corporation which in turn leases and rents automobiles to the public. Because the corporation's customers demand late model automobiles, taxpayer customarily sold his automobiles before the end of their physical life for a substantial price. The question, relating to the "reasonable" allowance for depreciation authorized by Section 23(1) of the Internal Revenue Code of 1939, is whether the leased automobiles are depreciable, as the Commissioner contends, on the basis of their estimated useful life in the taxpayer's business, using a depreciation base consisting of cost less the substantial resale value of the automobiles at the end of their useful life in taxpayer's business, rather than, as the court below held, on the basis of the longer physical life of the automobiles with cost less salvage value at the end of their physical life as the depreciation base.

STATUTE AND REGULATIONS INVOLVED

Section 23(1) of the Internal Revenue Code of 1939 and the pertinent sections of Treasury Regulations 111 are set forth in Appendix B, *infra*, pp. 49-52.

STATEMENT

The facts, as found by both courts below (Appendix A, *infra*, pp. 15-19, 41-45), may be summarized as follows:

During the taxable years 1950 and 1951, Robley H. Evans (taxpayer)¹ was engaged in the business of leasing automobiles and had been in that business as a proprietor since 1936. During the two years, taxpayer leased all of his automobiles to Evans U-Drive, Inc. (U-Drive), at the rate of \$45 per month per automobile. The lease agreement ~~BETWEEN~~ taxpayer and U-Drive provided that taxpayer would furnish to U-Drive a sufficient number of automobiles to efficiently operate and conduct an automobile rental business. Taxpayer, at all times, retained title to the automobiles, and had the right to sell and dispose of any of the automobiles at any time. (R. 26; Appendix A, *infra*, p. 42.)²

U-Drive engaged in two types of rental business during the taxable years. It leased about 30 to 40 per cent of its automobiles to customers for extended periods of time, *i. e.*, 18 to 36 months, and rented the remainder (70 to 60 per cent) to the general public on a short-term basis, *i. e.*, for a few hours, a few days, or a few weeks. (R. 27; Appendix A, *infra*, p. 42.)

¹ Julia M. Evans is a party solely because of the filing of joint returns for the two taxable years involved.

² The record references are to the certified record. The original record containing the exhibits has also been lodged with the Clerk of this Court.

To meet U-Drive's demands, taxpayer normally kept a supply of Chevrolet, Ford, and Plymouth automobiles on hand which he purchased new from local automobile dealers, usually at the factory price. The requirements of U-Drive's leasing and rental business were such that it was necessary for taxpayer to maintain a modern fleet of rental automobiles. Due to periodic fluctuations in U-Drive's rental car needs, however, taxpayer frequently owned more automobiles than were necessary for the efficient operation of U-Drive's short-term rental business. When this situation occurred, he examined the cars and sold those not needed. When sold, those automobiles usually had been driven an average of 15,000 to 20,000 miles and were generally in good mechanical condition. During the taxable years, taxpayer sold the automobiles used by U-Drive in the short-term rental phase of its business after they had been used about 15 months. Many automobiles were sold at the end of the tourist season, i. e., after Labor Day. (R. 27-28; Appendix A, *infra*, p. 43.)

At the termination of the extended-term leases, those automobiles would be returned to taxpayer who would sell them. If a new lease was executed, a new car was usually provided for the lessee. When sold, the automobiles might have been driven up to 50,000 miles and were between 18 and 36 months old. They were usually in good mechanical condition and state of repair. (R. 28; Appendix A, *infra*, p. 43.)

The surplus automobiles sold by the taxpayer during the years 1950-1951, could have been used longer

than they were; however, the customers of U-Drive demanded late-model automobiles that were currently in style. Older automobiles did not have much value as rental vehicles. Taxpayer sold most of his surplus automobiles to used-car dealers, jobbers, or brokers and, as a general rule, the automobiles were sold at current wholesale prices. (R. 28; Appendix A, *infra*, pp. 43-44.)

On his returns for the years 1950-1951, taxpayer computed depreciation on the theory that useful life means the physical life of an asset and that salvage value means scrap or junk value. On this basis, taxpayer had estimated that his automobiles had a useful life (*i. e.*, physical life) of 4 years, with no salvage value at the end of the 4-year period. Taxpayer's returns for 1950 and 1951 disclose that he sold 140 and 147 automobiles, respectively, in those years. Many of these automobiles had been held by taxpayer even less than 15 months, and the average actual decrease in value per car to taxpayer was \$270 in 1950 and \$100 in 1951. (R. 28-29; Appendix A, *infra*, p. 44.)

The Commissioner recomputed the allowable depreciation on the theory that, for purposes of depreciation, useful life means the useful life of an asset in the particular taxpayer's business, which may, as in this particular case, be less than physical life; and that salvage value is not limited to the scrap or junk value of an asset, but may be the substantial resale value remaining in an asset when it is no longer useful in the particular taxpayer's business. On this basis, the Commissioner estimated the useful

life of the taxpayer's automobiles to be 17 months, and the salvage value to be \$1,325 at the end of that period. (R. 29; Appendix A, *infra*, p. 44.)

The Tax Court accepted the Commissioner's view of useful life and salvage value, but made separate findings as between the short-term and extended-term rental cars. It found that during the taxable years involved the extended-term rental cars had a useful life of 3 years and a salvage value of \$600, while the short-term rental cars had a useful life of 15 months and a salvage value of \$1,375. (R. 29-30; Appendix A, *infra*, pp. 44-45.)

The Court of Appeals reversed and remanded, holding that the Tax Court had erred when it measured the useful life of the automobiles by the period which those assets were held in the taxpayer's business, and defined salvage value as the estimated proceeds which would be realized from the sale of the automobiles when they were no longer useful in the taxpayer's business. (Appendix A, *infra*, p. 34.)

REASONS FOR GRANTING THE WRIT

1. The decision below, involving the computation of the depreciation deduction authorized by Section 23(l) of the Internal Revenue Code of 1939 (Appendix B, *infra*, p. 49), is in direct conflict with the decision of the Court of Appeals for the Fifth Circuit in *United States v. Massey Motors*, 264 F. 2d 552. The depreciation issue in each case is the same and there are no material factual differences in the two cases. The decision below is also contrary to principles which this Court and the lower courts have stated in other cases.

The issue concerns the computation of the "reasonable" allowance provided in the 1939 Code, Section 23(1), as a deduction for the exhaustion, wear and tear, including a reasonable allowance for obsolescence, of property used in a trade or business, or held for the production of income. Under the pertinent Treasury Regulations, the capital sum to be replaced by the depreciation allowance is the cost or other basis of the property, which is to be charged off over the useful life of the property in such ratable amounts as may reasonably be considered necessary to recover the cost or other basis of the property less its salvage value.³ See Treasury Regulations 111, Section 29.23(1)-1, -4 and -5, Appendix B, *infra*, pp. 49-52. Usually property used in a trade or business has a useful life in the business which is coterminous with its physical life. However, the instant case and the *Massey Motors* case (as well as *Hertz Corporation v. United States*, 165 F. Supp. 261 (D. Del.) now pending on appeal to the Third Circuit) present situations where, because of the nature and operation of the business (the leasing and

³ The length of the useful life of an asset and the amount of the salvage value thereof are necessarily estimated at the time of the acquisition of the asset upon reasonably predictable conditions, and the reasonableness of the particular depreciation deduction claimed is determined in the light of conditions known to exist at the end of the tax year for which the return is made. *Cohn v. United States*, 259 F. 2d 371, 377-378 (C. A. 6th); *Commissioner v. Mutual Fertilizer Co.*, 159 F. 2d 470 (C. A. 5th); *Wier Long Leaf Lumber Co. v. Commissioner*, 9 T. C. 990, 998, modified on other grounds, 173 F. 2d 549 (C. A. 5th).

renting of automobiles), the property involved does not have a useful life in the business which is co-terminous with its physical life, and the property is consistently sold prior to the end of its physical useful life at a substantial resale price. Under such circumstances, the Commissioner has contended that, as a matter of law, the "reasonable" allowance for depreciation authorized by Section 23(1) must be computed with reference to the taxpayer's established business experience and practice as a rental car lessor and, accordingly, has computed the allowance on the basis of the estimated actual depreciation of the cars over their useful life in the taxpayer's business (rather than over their physical useful life), taking into account as salvage value the estimated resale value of the cars at the end of that period.*

The court below rejected this contention, holding that the leased cars are depreciable on the basis of their physical useful life and their salvage value at

* The expression "useful life of the property *in the business*" (italics supplied) was expressly used in Treasury Regulations from 1918 to 1942 (see Treasury Regulations 45, Article 161, and Treasury Regulations 103, Section 19.23 (b)-1) and is used in Bulletin "F", Bureau of Internal Revenue (Revised January, 1942), p. 2. The Regulations applicable for the taxable years involved here (Appendix B, *infra*, pp. 49-52) do not use that expression, for reasons amply explained by the Court of Appeals for the Fifth Circuit in *Massey Motors*, *supra*, pp. 557-558, but the concept is presently spelled out in detail in Treasury Regulations on Depreciation (1954 Code), Section 1.167(a)-1, interpreting Section 167(a) of the Internal Revenue Code of 1954 (26 U. S. C. 1952 ed., Supp. V, Sec. 167(a)) which is in substance the same as Section 23(1) of the 1939 Code.

the end of that time (which would necessarily be a nominal scrap or junk value). (Appendix A, *infra*, p. 34.) That holding was based on the ground that it has been the Commissioner's "long-continued and consistent practice and position" (*id.*, p. 27) to measure useful life by the physical life of the depreciable asset.

In *Massey Motors* the taxpayer is a franchised new car dealer which rented part of its inventory of new cars and sold them after approximately one year's use, either at the advent of new models or after the cars had been driven 40,000 miles. The question there, as here, concerns the proper computation of the taxpayer's depreciation deduction on the rented cars in relation to "useful life" and "salvage value." Rendering its decision after the decision below, the Fifth Circuit expressly disagreed with the decision below and held (264 F. 2d 552, 558) that the rented cars were depreciable on the basis of the taxpayer's "expected use of the cars in his business and not on the basis of the length of time the car is expected to be usable as a passenger automobile" and, as a necessary corollary, that the resale value of the cars should be deducted from the depreciation base.⁵ Thus, there is a square conflict between the decisions of the Fifth and Ninth Circuits on this issue.

The decision below is also contrary to long-standing principles stated in other cases which did not

⁵ The Fifth Circuit remanded the case to the trial court for a determination as to whether salvage value should be resale value of the cars at retail, that being how they were sold, or the value of the cars at wholesale, that being how they were purchased.

directly involve the meaning of "useful life." For the most part, it has been assumed that "useful life" refers to the physical useful life of the property simply because the physical useful life was also the useful life in the taxpayer's business. At the same time, however, it has been recognized that it is the useful life of the property in the taxpayer's business which is controlling.⁶ Thus, in *United States v. Ludey*, 274 U.S. 295, 300-301, this Court stated that:

The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the *useful life* of the plant *in the business*, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost. * * * [*Italics supplied.*]

See also, *Cohn v. United States*, 259 F. 2d 371, 377 (C.A. 6th); *Becker v. Anheuser-Busch, Inc.*, 120 F. 2d 403, 412 (C.A. 8th), certiorari denied, 314 U.S. 625; *Burlington Gazette Co. v. Commissioner*, 75 F. 2d 577, 578 (C.A. 8th); *Cameron v. Commissioner*, 56 F. 2d 1021, 1023 (C.A. 3d); *Coca-Cola Bottling Co. v. Commissioner*, 6 B.T.A. 1333, 1334; *McWilliams v. Commissioner*, 15 B.T.A. 329, 344-345; *Montgomery's Federal Taxes* (37th ed.), c. 6, pp. 4-6. This rule effectuates the purpose of the depreciation allowance, which, as stated in *Detroit Edison v. Com-*

⁶ Depreciation is now also allowed on property used for the production of income irrespective of whether a business is involved (see *United States v. Massey Motors, supra*, p. 557), but this extension of Section 23(l) requires no departure from basic principles.

missioner, 319 U.S. 98, 101, "is to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets".

The decision below, allowing the taxpayer a ratable depreciation deduction on the basis of the physical life of the automobiles, and their salvage value at the end of that time, when in fact the automobiles will not be used in his business over that entire period and will instead be sold at a substantial price while still in good mechanical and physical condition, sanctions "a grossly unreasonable deduction for depreciation" (*United States v. Massey Motors, Inc.*, *supra*, p. 558) which has no relation to the "financial" consequences of depreciation "to the taxpayer" and is contrary to the entire purpose of the depreciation allowance as stated by this Court in the *Detroit Edison* case.⁷ The holding below, authorizing use of

⁷ The effect of the excessive depreciation deduction is to permit the taxpayer to convert ordinary income into capital gain, since the depreciation allowance is applied as a deduction against the taxpayer's ordinary rental income and at the same time reduces the taxpayer's cost basis for the automobiles. When the automobiles are sold by the taxpayer, the difference between their actual resale price and the depreciated cost basis is taxed as capital gain under 1939 Code Section 117(j) (26 U.S.C. 1952 ed., Sec. 117(j)) and, accordingly, the excessive depreciation is in effect converted from ordinary income into capital gain. The tax which taxpayer pays on the capital gain at the low capital gain rate is more than overbalanced by the savings on the tax on his ordinary income taxed at the individual ordinary income rates. See *Cohn v. United States*, 250 F. 2d 371, 377 (C.A. 6th); Rabkin & Johnson, *Federal Income, Gift and Estate Taxation*, Vol. 2, Section 45.01, pp. 4504-4505.

what is necessarily a nominal salvage value, is also inconsistent with decisions holding that the salvage value may be a large percentage of the original cost of the asset when it is no longer useful in the taxpayer's trade or business but is useful in some other business. *Burnet v. Niagara Brewing Co.*, 282 U.S. 648, 655; *Goldberg v. Commissioner*, 239 F. 2d 316, 319 (C.A. 5th); *Cohn v. United States*, 259 F. 2d 371, 377 (C.A. 6th); *Kocling v. United States*, 171 F. Supp. 214, 224-226 (D.Neb.); *W. H. Norris Lumber Co. v. Commissioner*, decided October 12, 1948 (1948 P-H T.C. Memorandum Decisions, par. 48,204); *Davidson v. Commissioner*, decided September 24, 1953 (1953 P-H T.C. Memorandum Decisions, par. 53,317); *Bolta Co. v. Commissioner*, decided November 28, 1945 (1945 P-H T.C. Memorandum Decisions, par. 45,360, modified, par. 45,372); *Montgomery's Federal Taxes* (37th ed.), c. 6, pp. 13-14.

2. The question presented is of substantial and continuing importance. As the Fifth Circuit recognized in *Massey Motors, supra*, pp. 558-559, the question has recently become an acute one because of court holdings that rental automobiles are depreciable property used in the trade or business within the meaning of Section 117(j) and therefore the subject of capital gain treatment. The factual situation, i.e., one where as a matter of business practice property is customarily sold long before the end of its physical useful life and at a substantial price, applies not only to rented cars but to "company" cars of retail automobile dealers. See *Lynch-Davidson Motors, Inc. v. Tomlinson*, decided July 23, 1958

(2 AFTR 2d 5429). "Two cases presenting the same issue as the instant case, under the 1939 Code, are presently pending on appeal to the Fifth Circuit." As the opinion below recognizes (Appendix A, *infra*, p. 23), Section 23(1) of the 1939 Code has also been carried over and enacted as Section 167(a) of the 1954 Code, and the same basic issue presented here as to useful life and salvage value is presented, under the 1954 Code, in *Hertz Corporation v. United States*, 165 F. Supp. 261 (D.Del.), now pending on appeal to the Third Circuit." ~~The Internal Revenue Service~~

* *Davidson v. Tomlinson*, 165 F. Supp. 455 (S.D. Fla.); *Lynch-Davidson Motors, Inc. v. Tomlinson*, *supra*.

⁹ In *Hertz*, the issue is presented under the declining balance method of depreciation provided by Section 167(b) of the 1954 Code. Section 167(c) limits the application of this method to the cost of property with a "useful life of 3 years or more." The physical lives of taxpayer's cars were in excess of 3 years, but taxpayer used them in his business considerably less than that period. The taxpayer there claims that the cars qualify for the declining balance method of depreciation on the theory that useful life means the full physical life of the asset. The United States, as in the instant case, contends that useful life means the period over which the asset may reasonably be expected to be useful to the taxpayer in its business, and thus claims that the cars do not qualify under Section 167(c).

The District Court in *Hertz* held that the term "useful life," as used in Section 167(c), means the period during which the asset is useful to the taxpayer claiming the depreciation deduction, and that Section 1.167(a)-1(b) of Treasury Regulations on Depreciation (1954 Code), so defining the term, is valid. However, since the District Court was of the view (165 F. Supp. 261, 272-274) that the legislative history of the 1954 Code indicates that Congress intended that the Code would effect a change in the definition of "useful life" and that Congress proposed to terminate the practice of defining "useful life" as the whole physical life

estimates that there are now pending 503 cases involving more than \$16,000,000, which raise the issue under either the 1939 or 1954 Code.¹⁰

CONCLUSION

It is respectfully submitted that this petition for a writ of certiorari should be granted.

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JUNE 1959.

of the property, the District Court held (p. 275) that the Treasury Regulations on depreciation promulgated under the 1954 Code could not be applied retroactively to taxable years under that Code which ended prior to the promulgation of those Regulations on June 7, 1956. While we agree that the legislative history of the 1954 Code strongly demonstrates that the term "useful life" as used in Section 167 means useful life of the property to the taxpayer, we do not agree that the concept of useful life for tax depreciation purposes has ever had any other definition under the Treasury Regulations and it was so argued by the United States in its brief on appeal in *Hertz*. See H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 22, 23, 25, A 48; S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 25-27, 200.

¹⁰ The Service has also advised that many other cases have been settled on the basis of the theories of useful life and salvage value contended for by the Commissioner and approved by the Fifth Circuit in *Massey Motors* but rejected by the court below.

APPENDIX A

UNITED STATES COURT OF APPEALS FOR
THE NINTH CIRCUIT

No. 15,985

ROBLEY H. EVANS AND JULIA M. EVANS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Upon Petition to Review Decision of
The Tax Court of the United States

Decided January 26, 1959

Before: POPE, HAMLEY and JERTBERG, Circuit
Judges.

JERTBERG, Circuit Judge:

The main issue presented to this Court on the petition for review of the decision of the Tax Court of the United States centers on the rate of depreciation to which the taxpayers are entitled on automobiles used by them in their business of leasing automobiles to a corporation which was engaged in the business of leasing and renting automobiles to the public.

The Tax Court entered its decision finding deficiencies in income tax due from taxpayers for the years 1950 and 1951 in the respective amounts of \$13,191.52 and \$13,048.12.

There appears to be no dispute between the parties as to the character of the taxpayers' business or the

manner in which it was conducted during the years in question.

During the years 1950 and 1951 Robley H. Evans and Julia M. Evans¹ were husband and wife. During these years Robley H. Evans (hereinafter designated as petitioner) was engaged in the business of leasing automobiles to Evans U-Drive, Inc. (hereinafter called U-Drive) at a monthly rental of \$45.00 per month per automobile. U-Drive was engaged in the business of leasing and renting automobiles to the public, which business was managed by the petitioner.

The lease agreement between petitioner and U-Drive provided that petitioner was obligated to furnish U-Drive with a sufficient number of automobiles to enable it to conduct and operate an automobile leasing and renting business in an efficient manner.

During the taxable years under review U-Drive engaged in two types of rental activities, which for convenience might be termed short term rentals and extended rentals. Short term rentals varied from a few hours to several weeks. Extended rentals varied from eighteen months to thirty-six months, and accounted for thirty to forty per cent of automobile rentals.

Under the lease agreement with U-Drive, petitioner retained title to the automobiles, and had the right to sell and dispose of any of them at any time.

Petitioner periodically owned more automobiles than were necessary for the efficient operation of short term rentals. When this situation arose he would examine the cars in use and sell the number which were not needed. The oldest and least desir-

¹ Julia M. Evans is a party solely because of the filing of joint returns for the taxable years involved.

able cars were sold first. When sold, such cars had been driven an average of 15,000 to 20,000 miles, and were generally in good mechanical condition. Many automobiles were sold at the end of the tourist season. When sold, each car had been in use about fifteen months. These cars could have been used longer than they were, but customers of U-Drive demanded late model cars that were currently in style.

Automobiles to be used for extended rentals were purchased by petitioner when needed and leased to others by U-Drive. At the termination or cancellation of such leases, the automobiles were returned to petitioner, who sold them. When sold, such cars had been driven an average of 50,000 miles. They were generally in good physical condition and state of repair at the time of disposition, and petitioner could have continued to use them longer than he did.

Petitioner sold most of his surplus automobiles to used car dealers, jobbers, or brokers, and as a general rule the automobiles when sold brought current wholesale prices. Petitioner purchased new cars from local dealers, usually at factory prices.

Petitioners' tax returns for 1950 and 1951 revealed that he sold 140 and 147 automobiles respectively during those years. The average cost, sales price, depreciation claimed, and gain per car were approximately as follows:

Year	Cost	Sales Price	Depreciation Claimed	Gain
1950	1650	1380	515	245
1951	1495	1395	450	350

In such tax returns the amounts of depreciation taken were computed and deductions claimed on the basis that the automobiles had an estimated useful life of four years, with no salvage at the end of the four-year period.

• The Tax Court determined:

1. That the automobiles which petitioner leased to U-Drive during the taxable years for use under extended rentals had a useful life of three years and a salvage value of \$600.00;

2. That the automobiles which he leased to U-Drive for use under short term rentals had a useful life of fifteen months and a salvage value of \$1,375.00;

3. If the undepreciated [adjusted] cost of the automobiles in service at January 1, 1950 is less than \$600.00 and \$1,375.00 for the respective classes of automobiles, then that amount will be the salvage value of those automobiles.

Computations based upon such decision resulted in the amounts of deficiency above mentioned for the years under review.

In the notice of deficiency directed to petitioner, the Commissioner stated that "It has been determined that *the average useful life of the automobiles used in your business* based on your actual experience was not in excess of seventeen months and the average salvage value of said automobiles at the end of their useful life in your business was not less than \$1,325.00 or the adjusted basis of said automobiles as of January 1, 1950, whichever amount was the lesser." (Emphasis added)

The Tax Court found that "The surplus automobiles sold by Robley (Evans) could have been used longer than they were; however, customers demanded late model automobiles that were currently in style. Older automobiles did not have much value as rental vehicles. During the taxable years, Robley (Evans) sold the automobiles used by U-Drive in the short-term rental phase of its business after they had been used about 15 months. And he usually sold the auto-

mobiles which had been leased for extended terms as soon as the lease was terminated." The Tax Court further found that 30 to 40 per cent of the automobiles leased by petitioner to U-Drive were on the extended rental basis, which period was from 18 months to 36 months, and that as a general rule the automobiles were sold at current wholesale prices. In its opinion the Tax Court stated that petitioner had consistently claimed deductions for depreciation (apparently since 1936) on the basis that his automobiles had a useful life of four years, with no salvage value at the end of the four-year period.

It is the petitioner's position on this review that until the opinion of the Tax Court herein, judicial interpretation, administrative practice under the 1939 Code, and practice in the accounting profession generally, had long agreed that, for the purpose of the depreciation deduction, the term "useful life" means the physical, economic or functional life of the property subject to the depreciation allowance, and the term "salvage value"—the value remaining in depreciable property at the end of its physical, economic or functional life—means its residual or scrap value.

Analysis of the findings of fact, conclusions of law, and decision of the Tax Court unmistakably reflect that the Tax Court measured "useful life" by the holding period of the automobiles leased by petitioner to U-Drive, and measured "salvage value" by the estimated proceeds which might be realized upon the disposition of such automobiles.

The Tax Court's opinion contains no discussion as to the legal signification of the terms "useful life" and "salvage value". The concepts of such terms and the contentions in relation thereto as advanced by the petitioner were not mentioned. The question pre-

sented by this review is a narrow one, although not without its difficulties. In most instances, an asset used in the trade or business remains in the service of the taxpayer until its economic usefulness has been exhausted. Under such circumstances, no problem arises as to the useful life of the asset, and the value remaining in the asset at the end of such useful life—its salvage value—is generally its scrap or junk value. The problem is acute with respect to taxpayers, the nature of whose business requires, for various reasons, a policy of disposing of depreciable assets while such assets still possess substantial value, and which property brings on disposal prices considerably in excess of the scrap or junk value. Such a business is the type in which petitioner engages.

It is our view that the issue presented by the conflicting concepts of "useful life" and "salvage value" involve principally taxpayers engaged in such type of business whose tax years under the Internal Revenue Code of 1939 are open for review and assessment by the Commissioner. This issue may also involve taxpayers engaged in such type of business whose tax years prior to the enactment of Section 167 of the Internal Revenue Code of 1954 and the issuance of Treasury Regulations T.D. 6182 are likewise open for review and assessment. See *The Hertz Corporation, etc. vs. United States*, U.S. District Court, District of Delaware, (1958), 58-2 U.S.T.C., Paragraph 9520.

In enacting section 167 of the Internal Revenue Code of 1954 (Title 26 U.S.C.A., section 167), Congress authorized several new methods for computing depreciation for taxable years ending after December 31, 1953. Section 167(b) states that a "reasonable allowance" as used in section 167(a) shall include an allowance computed in accordance with regulations

prescribed by the Secretary, under any of the prescribed methods and rates. Sections 167(b) and 167(c) prescribe allowable methods and rates for computing depreciation, as well as certain limitations on the use of such methods. The allowable methods are the straight line method, the declining balance method, the sum of the years-digits method, and any other method productive of an annual allowance which does not exceed the allowance computed under the declining balance method. If an allowance is reasonable under section 167(a), it shall not be limited or reduced by any provision contained in section 167(b). Section 167(c) restricts the accelerated method contained in section 167(b) to new construction and to new tangible property with a useful life of three years or more.

Regulations under the Internal Revenue Code of 1954 were issued June 7, 1956, T.D. 6182, 1956—1 Cum. Bul. The depreciation provisions of these regulations relevant to this discussion are set forth in section 1.167(a)-1. Section 1.167(a)-1-(a) states that the allowance [reasonable allowance under section 167(a) of the Code] is "that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan [not necessarily at a uniform rate], so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property * * * An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. * * * The allowance shall not reflect amounts representing a mere reduction in market value."

Section 1.167(a)-1-(b) states "For the purpose of section 167 the estimated useful life of an asset is

not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. * * *

Section 1.167(a)-1-(c) states, "Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. * * * If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. * * *

Finally, for the guidance of taxpayers, there are now official definitions of the terms "useful life" and "salvage value", and definite rules for their application.

There can be no dispute over the fact that the Tax Court applied to the facts of this case definitions of "useful life" and "salvage value" which appeared for the first time in Regulations T.D. 6182, promulgated under the 1954 Code. The Commissioner does not seriously argue otherwise. His position appears to be that the concepts of "useful life" and "salvage value" embodied in the new regulations have been applied under all Revenue Acts and regulations since 1918, including the Internal Revenue Code of 1939, and regulations issued thereunder. The petitioner vigorously disputes such position.

We will now proceed to explore the validity of the petitioner's contention that until the opinion of the Tax Court herein, judicial interpretation,* administrative practice under the 1939 Code, and practice in the accounting profession, had long agreed that, for

the purpose of the depreciation deduction, the term "useful life" means the physical or economic life of the property subject to the depreciation allowance, and that the term "salvage value"—the value remaining in depreciable property at the end of its physical or economic life—means its residual or scrap value.

The basic statute on depreciation in the Internal Revenue Code of 1939 is section 23. This section in its relevant part provides: "Sec. 23. Deductions from gross income—In computing net income there shall be allowed as deductions * * * 1. Depreciation—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(1) of property used in the trade or business, or (2) * * *"

This basic provision relating to depreciation of property used in a trade or business has been a part of every Internal Revenue Act since 1918.² This same basic provision appears in the Internal Revenue Code of 1954.³

In none of the depreciation provisions contained in revenue acts from the Revenue Act of 1918 has Congress seen fit to define the term "reasonable" in providing for a "reasonable allowance" for exhaustion, wear and tear. This basic provision is so general as to render an interpretative regulation appropriate. *Morrissey, et al., Trustee vs. Commissioner of Internal Revenue*, 296 U.S. 344; *Helvering, Commissioner of Internal Revenue vs. R. J. Reynolds Tobacco Co.*, 306 U.S. 110.

Treasury Regulations 111 (1942) were promulgated under the Internal Revenue Code of 1939, and

² Sec. 234(a)-1 and Sec. 241(a)-8 of the Revenue Act of 1918, c. 18, 14 Stat. 1057.

³ Sec. 167, Title 26 U.S.C.A.

are applicable to the years 1950 and 1951, which are the taxable years under review. The relevant portions of Regulations 111 are contained in section 29.23(1). Pertinent extracts from such section are: " * * * The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis * * * " Section 29.23(1)-1.

"The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. * * * " Section 29.23(1)-4.

"The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, * * * The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonable be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. * * * " Section 29.23(1)-5.

The first appearance of the terms "useful life" and "salvage value" in Treasury Regulations was in Treasury Regulations 45, Article 161 (1919), effective for the calendar years 1918-19 and 1920. Article 161 provided in part; as follows: "The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the *useful life of the property in the*

business will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost * * * (Emphasis added)

Article 165 of the same Regulations provided in part, as follows: "The capital sum to be replaced *should be charged off over the useful life of the property* * * * (Emphasis added)

Similar wording with changes not material to the problem before us appeared in subsequent Treasury Regulations through Regulations 103, Section 12.23 (1)-1-5, effective for the tax years 1939-40 and 1941. The words "in the business" which appeared in Article 161 of Regulations 45 continued to appear in successive regulations until the issuance of Regulations 111 in 1942. No definition or further explanation of the terms "useful life" or "salvage value" appeared in any of the regulations to which reference has been made until the issuance of Treasury Regulations T.D. 6182, promulgated under the 1954 Revenue Code. The terms "useful life" and "salvage value" are not defined or explained in Regulations 111. The language of the Regulations does not limit "useful life" to the useful life of the depreciable assets in the business of the taxpayer or to the period during which such assets are held by the taxpayer.

The significance, if any, to be attached to the omission of the words "in the business" from Regulations 111 is obscure. We attach no significance thereto because in our view the practice and position of the Commissioner has been the same under Regulations 45 and succeeding regulations up to T.D. 6182, except for a few recent cases under Regulations 111 of the Internal Revenue Code of 1939,⁴ in which

⁴ *Koelling vs. United States*, U.S. District Court for the District of Nebraska (1957), 57-1 U.S.T.C., Paragraph 9153;

the Commissioner asserted the concepts of "useful life" and "salvage value" embodied in T.D. 6182.

From the practice of the Commissioner over the years, it appears to us that the phrase "in the business" included in earlier regulations simply defined the type of assets which were subject to the depreciation allowance. The omission of such phrase from Treasury Regulations 111 would not furnish the basis for an interpretation of the term "useful life" which it did not have when the phrase appeared in the regulations.

As stated above, the basic statutory provision relating to depreciation of property used in a trade or business was so general as to render an interpretative regulation appropriate. Section 3791 of the Internal Revenue Code of 1939 states that the Commissioner, with the approval of the Secretary, "shall prescribe and publish all needful rules and regulations for the enforcement of this title." Pursuant to such Congressional direction, the Commissioner issued Regulations 111, of which section 29.23(1) is a part. This section was prepared by the department charged with the enforcement of the Act. In carrying out the Congressional directive, it was necessary for the Commissioner to select some base on which the annual allowance for depreciation might be measured. The language in section 29.23(1) indicates that the Commissioner selected as the base the estimated physical or economic life of the depreciable asset, and not the estimated holding period of such asset in the hands of the taxpayer. The section represents a fairly contemporaneous construction by the Commissioner of the statute. The section is not in

Pilot Freight Carriers, Inc. vs. Commissioner (1956), 15 Tax Court Memo 1027; the instant case (1957), 16 CCH, Tax Court Memo 156.

conflict with the express provisions of the statute. It is reasonably adapted to the enforcement of the Act. If there exists any doubt as to the construction to be placed on the language of section 29.23(1), such doubt disappears in the light of the consistent practice and position of the Commissioner from 1939 to 1956. No decision of the United States courts or the Tax Court has been called to our attention, except the very recent decisions heretofore mentioned, in which the Commissioner asserted that the term "useful life" should be limited to the period during which the depreciable asset was held by the taxpayer. On the contrary, the consistent, long-continued practice and position of the Commissioner were that "useful life" of the depreciable asset was its estimated physical or economic life.

Our attention has been directed to certain pronouncements of the Commissioner dealing with the general subject under review.⁵ In each of such pronouncements, it is evident that the Commissioner's concept of the term "useful life" was not measured by the period in which the depreciable asset was useful in the taxpayer's business, but was measured rather by the economic or physical life of the depreciable asset.

Further evidence of the position of the Commissioner is drawn from his acquiescence in decisions of the Board of Tax Appeals⁶ which measured "useful life" of the depreciable asset not by the holding

⁵ O.D. 845, Cumulative Bulletin—January-June 1921, page 178. I.R. Bulletin 108, 1953—1 CB 185; and Rev. Rul. 54-229, 1954—1 CB 124.

⁶ *Sanford Cotton Mills*, 14 BTA 1210 (1929), Acq. X-2 CB 63; *Merkle Broom Co.*, 3 BTA 1084 (1926), Acq. V-2 CB 2; *Max Kurtz, et al.*, 8 BTA 679 (1927), Acq. VII-1 CB 18.

period of such asset by the particular taxpayer, but by the economic or physical life of such asset.

In the case of *General Securities Co.*, BTA Memo., CCH Dec. 12,500-D (1942), affirmed per curiam 137 F.2d 201, the taxpayer claimed a useful life of three years for automobiles used in its business. The taxpayer kept its cars one or two years, and when traded in after one year the cars retained a value of from one-third to one-half of their original value. The Commissioner attempted to compel the taxpayer to depreciate such automobiles over a useful life of more than three years. The Tax Court found that the normal useful life of such automobiles was three years.

In the recent case of *Philber Equipment Corp. vs. Commissioner of Internal Revenue*, 237 F. 2d 129 (C.A. 3d 1956), taxable years 1951-52 were involved. The taxpayer was engaged in the business of furnishing trucks, trailers and tractors to the public on a lease basis. The single issue in that case was whether the motor vehicles owned by taxpayer were "held primarily for sale to customers in ordinary course of petitioner's trade or business" within the meaning of Sections 117(a), and (j) of the Internal Revenue Code of 1939, 26 U.S.C.A. section 117(a) and (j). The court stated at page 130: "During the taxable years, existing conditions made it difficult or impossible to re-lease most of the equipment. Taxpayer knew that when equipment was purchased, it would probably be able to rent the equipment for a period substantially less than its useful life, and sale of the equipment would follow expiration of a lease." The Commissioner stated in his brief⁷ filed in that

⁷ Brief of respondent, *Philber Equipment Corp. vs. Commissioner of Internal Revenue*, C.A. 3rd, Docket No. 11,860.

case, "Because of existing conditions taxpayer knew when it purchased equipment that it would likely be able to rent such equipment only for a period that was substantially less than its useful life." (Page 5 of brief). At page 11 of the brief, the Commissioner stated, " * * * all of the leases involved were only for a one-year term, a period substantially less than the useful life of this type of equipment as its resale in the tax years and re-lease in later years demonstrated." The statements of the Commissioner in the above case are simply confirmatory of the position taken by the Commissioner over a period of many years.

Petitioner calls attention to Internal Revenue Bulletin "F", which was issued in 1920 and revised in 1942. It was republished as Internal Revenue Bulletin 173 in 1955. This bulletin sets forth general depreciation policy and tables of estimated lives of particular kinds of assets. This bulletin is titled "Income Tax Depreciation and Obsolescence, Estimated Useful Lives and Depreciation Rates." The title page states, "This bulletin supersedes Bulletin 'F' (revised January 1931) and 'Depreciation Studies' (published January 1931). It contains information and statistical data relating to the determination of deductions for depreciation and obsolescence, from which taxpayers and their counsel may obtain the best available indication of Bureau practice and the trend and tendency of official opinion in the administration of pertinent provisions of the Internal Revenue Code and corresponding or similar provisions of prior Revenue Acts. It does not have the force and effect of a Treasury Decision and does not commit the Department to any interpretation of the law which has not been formally approved and promulgated by the Secretary of the Treasury."

In the first paragraph of the Introduction (Part I, page 1 of the Bulletin) it is stated: "The Federal income tax in general is based upon net income of a specified period designated as the taxable year. The production of net income usually involves the use of capital assets which wear out, become exhausted, or are consumed in such use. The wearing out, exhaustion, or consumption usually is gradual, extending over a period of years. It is ordinarily called depreciation, and the period over which it extends is the normal useful life of the asset."

The first paragraph on page 3, under the heading "Probable Useful Life—Rates of Depreciation and Obsolescence" is as follows: "In general.—The amount of the annual deduction allowable for depreciation is ordinarily dependent upon the expected useful life of the asset. The factors which determine the useful life of property in a trade or business have already been discussed briefly in the Introduction. These factors are wear and tear and decay or decline from natural causes; and also various forms of obsolescence attributable to the normal progress of the art, economic changes, inventions, and inadequacy to the growing needs of the trade or business. Two principal forms or types of obsolescence are generally recognized, that is, normal obsolescence and extraordinary special obsolescence."

At page 7, under the heading of "Salvage" it is stated: "Salvage value is the amount realizable from the sale or other disposition of items recovered when property has become no longer useful in the taxpayer's business and is demolished, dismantled, or retired from service. * * *"

Under the heading "Lives of Depreciable Property" is the following: "In this compilation are listed for each industry the useful lives of various assets,

including wherever practicable lives for composite accounts and group accounts. * * * All lives are given without fractional years. In practice, however, fractions may be used."

The recommended useful life on motors and other vehicles appears on page 52. Therein it is stated, "Motor vehicles included in this classification are those used by commercial enterprises other than public utility and construction.

Lives considered reasonable are indicated below:

Automobiles:

Years

Passenger
Salesman

5
3 * * *

In the instant case, as noted above, the petitioner used a useful life of four years in his depreciation schedules.

While we recognize that Bulletin "F" does not have the force of law, we do believe that a fair construction of the pertinent provisions of such Bulletin, aided by the practice of the Commissioner, reasonably indicates that the Commissioner did not consider as a factor in determining depreciation the expected or intended disposal plans of the taxpayer with respect to property used in his trade or business, nor did the Commissioner consider that the useful life of an asset was to be measured by the estimated holding period of such asset by the taxpayer.

Decisions of the Board of Tax Appeals and the Tax Court^{*} extending over many years have, but

^{*} *West Virginia & Pennsylvania Coal & Coke Co.*, 1 BTA 790 (1925); *J. R. James*, 2 BTA 1071 (1925), Acq. V-1 CB 3; *Wallace G. Kay*, 10 BTA 534 (1928), Acq. VII-1 CB 17; *W. N. Foster, et al.*, 2 TCM 595 (1943); *John A. Maguire Estate, Ltd.*, 17 BTA 394 (1929), Acq. IX-1 CB 34; *Nat. Lewis*, 13 TCM 1167 (1954); and *Whitman-Douglas Co.*, 8 BTA 694 (1927).

with little discussion, measured the useful life of a depreciable asset used in the trade or business of the taxpayer not by the holding period of such asset by a particular taxpayer but by the economic or physical life of such asset.

In a recent decision of the United States District Court⁹ involving the same tax years as in the instant case, the same type of business, and the same disposal practice as to automobiles, the court upheld the taxpayer's depreciation practice based on a useful life of three years. Similar holdings were made in district court cases.¹⁰

In *The Hertz Corporation, etc. vs. United States*, supra, the litigation arose under the Internal Revenue Code of 1954, the tax years involved being the years ending March 31, 1954, 1955 and 1956. The district court refused to apply the concept of "useful life" set forth in T.D. 6182 to taxable years prior to the promulgation of such regulations. The court stated: "The final question is whether or not, under the circumstances, the Commissioner may apply these regulations retroactively to include years prior to their promulgation. Retroactive laws are not favored. Long prior to the issuance of the new regulations in 1956, the Commissioner by his pronouncements and conduct had apparently acquiesced in the construction of 'useful life' given to the phrase by business and accounting circles and had been permitting taxpayers to make use of the declining-balance

⁹ *Massey Motors, Inc. vs. United States of America* (U.S. District Court, S.D. Florida 1957), 156 F.Supp. 516.

¹⁰ *Davidson vs. Tomlinson* (U.S. District Court, S.D. Florida, 1958), reported in 58-2 U.S.T.C., Paragraph 9739; *Lynch-Davidson Motors, Inc. vs. Tomlinson* (S.D. Florida, 1958), reported at 58-2 U.S.T.C., Paragraph 9738.

method of depreciation in situations similar to this. Nor did the language of the regulations (prior to that now under consideration) give any indication that the hitherto long-settled interpretation of the term would be changed. Furthermore, when the words 'useful life of the depreciable property' were inserted in the Regulations in 1942, they were capable of the construction that 'useful life' meant the whole physical life of the property.

"Taxpayers had a right to file their returns in reliance upon the Commissioner's long-continued interpretation of his own Regulations. Here a new regulation has been promulgated defining the term 'useful life' pursuant to a statute which for the first time has employed the term and where the intention of Congress with respect to its definition is clearly contrary to the interpretation, as evidenced by conduct and frequent pronouncements, which the Commissioner has given it in the past. Common justice requires that it be given a prospective construction only. * * *"

The long-continued and consistent practice and position of the Commissioner in measuring useful life by the physical or economic life of the depreciable asset were reflected in testimony before the Tax Court. At the trial in the Tax Court, two witnesses testified on behalf of petitioner. Both were certified public accountants licensed to practice their profession in several states, and both were admitted to practice before the Treasury Department. Each was a member of a separate accounting firm which practiced accounting nationwide. Each witness stated that he had had experience representing taxpayers before the Internal Revenue Service on depreciation matters. One witness had practiced his profession since 1930, and the other since 1934. Both testified

that in the accounting profession the term "useful life" for depreciation purposes denoted the physical life or economic life of a particular asset, and that the term "salvage value" denoted the junk or scrap value of an asset at the expiration of its useful life. Both testified that in their experience in dealing with the Internal Revenue Service prior to 1954, on the subject of depreciation, the practice of the Internal Revenue Service was to apply the same concepts of such terms as such concepts were generally understood in the accounting profession. The respondent offered no testimony on the subject. The Tax Court stated, in admitting such evidence, that such testimony was not controlling.

In light of the language of Section 29.23(1), the consistent practice and position of the Commissioner over many years, the interpretation placed on the term "useful life" by decisions of the Tax Court extending over a long period, we hold that under the Internal Revenue Code of 1939 the Tax Court erred when it measured useful life of the depreciable assets involved here by the period during which such assets were held in the business of petitioner instead of the physical or economic life of such assets. The application by the Tax Court of an erroneous concept of "useful life" necessarily requires a re-determination by the Tax Court of "salvage value". The Tax Court determined salvage value to be the estimated proceeds which would be realized from such assets when they were no longer useful in the business of petitioner and were to be disposed of by him, instead of the estimated proceeds which would be realized upon the sale or other disposition of such assets at the end of their physical or economic life. We do not agree with the petitioner's contention that the value remaining in such assets at the end of their

physical or economic life necessarily means scrap or junk value. Initially, petitioner should have estimated salvage value upon acquisition of such assets and such value should have been adjusted at the end of each taxable year if conditions then existing reasonably indicated that a different value would probably be realized at the end of the physical or economic life from the sale or other disposition of such assets.

The period over which useful life—meaning the physical or economic life—extends and the salvage value at the end of such period are questions of fact to be determined by the Tax Court on the remand of this cause.

In support of the decision of the Tax Court, the Commissioner argues, *inter alia*, that obsolescence was the principal factor in the depreciation of petitioner's automobiles, and that the depreciation deduction must be based upon and take into consideration obsolescence as well as exhaustion caused by physical wear and tear. The cogency of such observation is not clear to us unless the Commissioner intends to suggest that petitioner should have but failed to claim depreciation based on obsolescence in addition, to claiming depreciation caused by exhaustion through wear and tear. No meaningful mention of the word "obsolescence" appears in the findings, conclusions, decision of the Tax Court, or elsewhere in the record.

Regulations 111 covering the taxable years here in issue provide in section 29.23(1)-6, in part: "With respect to physical property the whole or any portion of which is clearly shown by the taxpayer as being affected by economic conditions *that will result in its being abandoned at a future date prior to the end of its normal useful life*, so that depreciation deduc-

tions alone are insufficient to return the cost or other basis at the end of its economic term of usefulness, a reasonable deduction for obsolescence, in addition to depreciation, may be allowed in accordance with the facts obtaining with respect to each item of property concerning which a claim for obsolescence is made. (Emphasis added) There is no evidence in the record which suggests that obsolescence is a factor which should be considered in this case. The foundation for obsolescence is, according to the Regulations, the expected early abandonment of the property. The term "abandon" has been held not to include property which was to be sold at a time when it had substantial value and was to be used for other purposes instead of being scrapped. *The Olean Times-Herald Corporation*, 37 BTA 922 (1938); *Southeastern Building Corporation*, 3 TC 381 (1944), affirmed 148 F. 2d 879 (C.A. 5th, 1945), certiorari denied 326 U.S. 740; *Bradley vs. C.I.R.*, 184 F. 2d 860.

The Commissioner also asserts that the decision of the Tax Court must be affirmed because petitioner is not entitled to convert ordinary income into capital gain through the depreciation deduction, and that section 117(j) of the Internal Revenue Code of 1939, which permitted capital gain upon the sale or exchange of certain property used in a trade or business, must be applied in such a manner that only a "reasonable allowance" for depreciation be deducted.

In his deficiency notice, the Commissioner stated: "It is further held that you were also in the business of selling used automobiles during the years 1950 and 1951. Consequently, the profit realized from the sale of the automobiles was income from the sale of property held primarily for sale in the ordinary course of your business within the meaning of section

117(j) of the Internal Revenue Code and such income may not be treated as a capital gain under the above-mentioned section of the Code. * * * The Commissioner abandoned that issue in his brief filed with the Tax Court and conceded the right of petitioner, under section 117(j), to treat the sales of his automobiles as sales of property used in his trade or business, not held primarily for sale to customers in the ordinary course of business. The Commissioner's abandonment of this approach was probably influenced by the decision of *Philber Equipment Corp. vs. Commissioner of Internal Revenue*, supra. That case involved the same type of business in which petitioner engages and with similar disposal practices of automobiles. The court held, since the circumstances disclosed that the acquisition, use and disposition of taxpayer's vehicles was consistent with business purposes of vehicle rental, that his vehicles were not held primarily for sale to customers, and thus the gain from the sale of such vehicles was not ordinary income but was capital gain and was taxable as such.

The argument is not convincing in the light of the long-continued and consistent practice of the Commissioner outlined above, which led taxpayers to adopt a method of depreciation which the Commissioner now contends results in unreasonable deductions for depreciation, and the legislative history of section 117(j). In amending, in 1942, section 117 of the Internal Revenue Code of 1939 by adding sub-section (j), Congress extended to taxpayers who sold at a profit depreciable assets used in a trade or business, held for more than six months, and not held primarily for sale to customers in the ordinary course of business, the favorable treatment on such profits accorded to capital gains. The legislative history of section 117(j) shows that Congress has

not receded from its original purpose. Congress was aware of the Commissioner's contention that taxpayers were converting into capital gains ordinary income arising from unreasonable deductions for depreciation.

Congress and the Treasury Department were well aware of the losses in revenue occurring under section 117(j). The report of the Business Tax Section of the Division of Tax Research of the Treasury Department submitted to the Ways and Means Committee of the House of Representatives (see "Revenue Revisions," 1947-1948, hearings of December 2-12, 1947, Part 5, page 3756) contained warnings against revenue losses through the benefits of capital gain treatment of profits from sale of assets subject to accelerated depreciation, and recommended that if the taxpayer elects to use accelerated depreciation, gains to the extent of the excess of accelerated over normal depreciation should be treated as ordinary income. Congress took no action. In 1950 the Treasury Department recommended to Congress that losses on the sale of depreciable business assets be treated as capital rather than ordinary losses (see Committee Reports on HR-8920, 81st Congress, Second Session). Again Congress did not act. On April 19, 1954, the Committee on Federal Taxation of the American Institute of Accountants filed with the Senate Finance Committee its recommendation number 180, with respect to section 1231 of the proposed Internal Revenue Code of 1954, as follows: "Gain or loss of property used in the trade or business, etc.; should be treated uniformly as ordinary income or loss."¹¹ The recommendation was heard but not adopted.

¹¹ Hearings before the Committee on Finance, U.S. Senate, 83rd Congress, Second Session, on HR-8300, Part 3, page 1324.

In the Revenue Code of 1954, Congress limited capital gains on sales of emergency facilities amortized under section 168, but did not limit capital gains upon the sale of assets used in a trade or business. The House report ¹² states, with respect to section 1231, "This section is derived from section 117(j) of the present law. There is no substantive change intended but some rearrangement has been made."

The Commissioner contends that to define "useful life" as the physical or economic life of a depreciable asset does violence of the Congressional intent expressed in the basic statute that there shall be allowed as a deduction from gross income "a reasonable allowance for exhaustion, wear and tear * * * of property used in the trade or business * * *" and is contrary to the theory underlying such allowance that the yearly depreciation deduction reasonably reflect that portion of the value of the capital assets consumed in earning the gross income for the taxable year, citing *U.S. vs. Ludey*, 274 U.S. 295; *Virginia Hotel Co. vs. Helvering*, *Commissioner of Internal Revenue*, 319 U.S. 523; *Detroit Edison Co. vs. Commissioner of Internal Revenue*, 319 U.S. 98.

Again, the Commissioner overlooks the force of his own regulations, his long-continued, consistent practice thereunder, and the Congressional intent expressed in the enactment and subsequent legislative history of section 117(j).

Finally, the Commissioner contends that the findings of fact of the Tax Court that the short term rental cars had a useful life of 17 months and the long term rental cars had a useful life of three years

¹² Page 275 of House Report No. 1337, 83rd Congress, Second Session.

each, and that each car of each class had a value of \$1,325 and \$600 respectively, must be accepted by this Court unless clearly erroneous. Such findings are conclusions of law, legal inferences from the evidentiary facts or, in any event, determinations of questions of law and fact. They were arrived at by the application of erroneous concepts of the terms "useful life" and "salvage value". Under such circumstances we are not bound by the "clearly erroneous" rule. *Curtis vs. Commissioner of Internal Revenue*, 232 F. 2d 167; *Helvering vs. Tex-Penn Oil Co.*, 300 U.S. 481.

The decision of the Tax Court is reversed and the cause remanded to the Tax Court for further hearing and proceedings for the redetermination of the tax liability of petitioners in a manner consistent with the views expressed herein.

Judgment

Filed and entered January 26, 1959

Upon Petition to Review a Decision of the Tax
Court of the United States

This cause came on to be heard on the Transcript of the Record from the Tax Court of the United States, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Decision of the said Tax Court in this cause be, and hereby is reversed, and that this cause be, and hereby is remanded to the said Tax Court for further hearing and proceedings for the redetermination of the tax liability of petitioners in a manner consistent with the views expressed in the opinion of this Court.

TAX COURT OF THE UNITED STATES

Docket No. 58067

ROBLEY H. EVANS AND JULIAN M. EVANS,
PETITIONERS

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Memorandum Findings of Fact and Opinion

Tietjens, Judge:

The Commissioner determined deficiencies in the petitioners' income taxes for the years 1950 and 1951 in the respective amounts of \$32,847.62 and \$49,514.04. The petitioners conceded that certain adjustments made by the Commissioner were correct. The Commissioner also conceded that certain of his adjustments were improper. The only issue left for our decision arises from the Commissioner's partial disallowance of claimed depreciation deductions. He determined that automobiles used in the petitioners' business had a shorter useful life than claimed and also a salvage value. A stipulation of certain issues in controversy was filed by the parties. It is incorporated herein by this reference.

Findings of Fact

The stipulated facts are so found and are incorporated herein by reference.

The petitioners, Robley H. Evans and Julia M. Evans, are husband and wife. They reside in Bellevue, Washington, and filed their joint income tax returns for the years 1950 and 1951 with the col-

lector of internal revenue for the district of Washington.

During the years 1950 and 1951 Robley was engaged in the business of leasing automobiles in the vicinity of Seattle. He has been in that business as a proprietor since 1936. During 1950 and 1951 Robley leased all of his automobiles to Evans U-Drive, Inc., (hereinafter referred to as U-Drive) a corporation, at the rate of \$45 per month per automobile.

U-Drive was organized in 1949. All of its outstanding stock was held by Robley's son, Robert J. Evans, until near the end of 1951 at which time Robley acquired a portion of the stock. Robley was the manager of U-Drive.

The lease agreement between Robley and U-Drive provided that Robley would furnish and lease to U-Drive a sufficient number of automobiles to efficiently operate and conduct an automobile rental business. Robley retained title to the automobiles and had the right to sell and dispose of any of the automobiles at any time. U-Drive agreed to pay all expenses of maintenance and repair of the automobiles and also to keep the automobiles insured against liability for personal injury or property damage. U-Drive also assumed the risk of loss or damage. A supplemental agreement dated December 1, 1951, gave U-Drive an option to purchase any automobile in its possession at any time, for the actual cost of the automobile to Robley.

U-Drive engaged in two types of activity during the taxable years. It leased about 30 to 40 per cent of its automobiles to customers for long periods of time, i.e., 18 to 36 months and it rented the remainder of its automobiles to the general public on a short-term basis, i.e., for a few hours, a few days, or a few weeks.

Robley normally kept a supply of Chevrolet, Ford and Plymouth automobiles on hand, which he purchased new from local automobile dealers, usually at the factory price. He endeavored to maintain a modern fleet of rental automobiles as this was necessary to meet the demands of U-Drive's leasing and rental business.

Robley periodically owned more automobiles than were necessary for the efficient operation of U-Drive's short-term rental business. When this situation occurred, he would examine the cars in use and would sell those that were not needed. The oldest and least desirable automobiles were sold first. When sold, the automobiles usually had been driven an average of 15,000 to 20,000 miles and were generally in good mechanical condition. Many automobiles were sold at the end of the tourist season, i.e., after Labor Day.

At the termination of U-Drive's extended period leases, the automobiles would be returned to Robley who would sell them. When sold, the automobiles might have been driven up to 50,000 miles. They were usually in good mechanical condition and state of repair at the time of sale.

The surplus automobiles sold by Robley could have been used longer than they were; however, customers demanded late model automobiles that were currently in style. Older automobiles did not have much value as rental vehicles. During the taxable years, Robley sold the automobiles used by U-Drive in the short-term rental phase of its business after they had been used about 15 months. And he usually sold the automobiles which had been leased for extended periods as soon as the lease was terminated. If a new lease was executed, a new car was usually provided for the lessee.

Robley sold most of his surplus automobiles to used car dealers, jobbers, or brokers. As a general rule, the automobiles were sold at current wholesale prices. Robley did not advertise the sales of his automobiles nor did he maintain a showroom or any other retail facilities for sale of his surplus automobiles.

Robley's tax returns for 1950 and 1951 disclosed that he sold 140 and 147 automobiles, respectively, in those years. The average cost, sales price, depreciation claimed, and gain per automobile, were approximately as follows:

Year	Cost	Sales Price	Depreciation	Gain
			Claimed	
1950.....	\$1,650	\$1,380	\$515	\$245
1951.....	1,495	1,395	450	350

Most of the automobiles sold had been held by Robley less than 15 months.

On his tax returns for the years 1950 and 1951 Robley claimed depreciation on the automobiles he leased to U-Drive in the respective amounts of \$77,972.71 and \$92,890.05. These amounts were computed and the deductions claimed on the basis that the automobiles had an estimated useful life of 4 years, with no salvage value at the end of the 4-year period.

The Commissioner determined allowable depreciation on these automobiles for the years 1950 and 1951 on the basis of an estimated useful life for each automobile of 17 months and a salvage value of \$1,325 at the end of the 17-month period, or the amount of undepreciated cost at January 1, 1950, for automobiles in use at that date, if less than \$1,325.

The automobiles leased to U-Drive during the taxable years for use under extended term leases, had a useful life of 3 years and a salvage value of

• \$600. However, if the undepreciated cost of such automobiles in service at January 1, 1950, is less than \$600, then that amount will be the salvage value of those automobiles.

The automobiles leased to U-Drive during the taxable years for short-term rental use, had a useful life of 15 months and a salvage value of \$1,375. However, if the undepreciated cost of such automobiles in service at January 1, 1950, is less than \$1,375, then that amount will be the salvage value of those automobiles.

Opinion

The sole question for decision relates to the rate of depreciation to be used by Robley upon automobiles used by him in his business of leasing automobiles to U-Drive, a corporation owned solely by his son until the latter part of 1951, at which time Robely acquired a portion of the stock. U-Drive engaged in two types of activities. It leased about 30 to 40 per cent of its automobiles to customers for extended periods of time (18 to 36 months) and it rented the remainder of its automobiles to the public for short periods of time (a few hours, days, or weeks).

Section 23(1) of the Internal Revenue Code of 1939 provides for the deduction of a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in the trade or business.

Regulations 111, Section 29.23(1) provide that the proper allowance for depreciation is that amount, which should be set aside for the taxable year whereby the aggregate of the amounts so set aside, plus the salvage value will, at the end of the useful life of the property, equal the cost or other basis of the

property. See also *United States v. Ludley*, 274 U. S. 295 (1927). The reasonableness of depreciation claimed is to be determined in the light of conditions known to exist at the end of the period for which the return is made. *Leonard Refineries, Inc.*, 11 T.C. 1000 (1948).

Robley has consistently claimed deductions for depreciation on the basis that his automobiles had a useful life of 4 years, with no salvage value at the end of the 4-year period. The Commissioner however determined allowable depreciation on Robley's automobiles for the taxable years on the basis of an estimated useful life of 17 months and a salvage value of \$1,325, or the amount of undepreciated cost at the beginning of the first taxable year for automobiles in use at that date, if less than \$1,325.

Robley has engaged in the business of leasing automobiles as a sole proprietor since 1936. During World War II and for several years thereafter, automobiles were scarce and Robley was forced to use his automobiles for long periods of time before selling them and acquiring new ones. Depreciation claimed by Robley on the basis of a useful life of 4 years may not have been unreasonable during that period, though we think he still should have provided for a salvage value in his computation.

However, in 1949, when new automobiles were more easily obtainable, Robley's son organized U-Drive, and Robley began leasing all of his automobiles to that corporation. Robley's lease agreement with U-Drive provided that he would furnish and lease a sufficient number of automobiles to operate and conduct an automobile rental business efficiently. To carry out the lease, Robley thus had to provide automobiles to U-Drive with which the latter could meet competition and that competition required him to furnish U-Drive with late model automobiles with

modern equipment, i.e., automatic transmissions, etc.

Robley would furnish new automobiles to U-Drive for its extended period leases. At the termination of those leases some 18 to 36 months later, the automobiles would be returned to Robley who would then sell them. If the customer renewed his lease, he would be provided with another new automobile. Current model automobiles were provided for the short-term rentals. Many of these were returned to Robley at the end of the tourist season, when demand for rental automobiles subsided, and they were sold by him at that time. Robley would start to purchase new model automobiles as soon as they came on the market in order to replenish his fleet and would continue doing so, as required by U-Drive's needs. Thus Robley was continually buying new automobiles and selling "old" ones as they were returned to him by U-Drive even though many of the latter automobiles were barely "broken in." U-Drive's competition required this method of operation and in view of this change in Robley's operations, we think that the Commissioner was justified in adjusting Robley's method of depreciating his automobiles. However, we think that the Commissioner's adjustment should have taken into consideration the two different uses made of the automobiles leased to U-Drive, i.e., extended-term leases and short-term rentals.

We have made a finding, and we so hold, that the automobiles which Robley leased to U-Drive during the taxable years for use under extended term leases had a useful life of 3 years and a salvage value of \$600, and that the automobiles which it leased to U-Drive for short-term rental, had a useful life of 15 months and a salvage value of \$1,375. If the un-depreciated cost of the automobiles in service at January 1, 1950, is less than \$600 and \$1,375 for the re-

spective classes of automobiles, then that amount will be the salvage value of those automobiles. See J. W. McWilliams, 15 B.T.A. 329 (1929).

Decision will be entered under Rule 50.

Filed: July 31, 1957.

Entered: August 1, 1957.

Served: August 1, 1957.

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion, filed July 31, 1957, the petitioners and respondent filed differing computations of tax. Hearing was had on February 5, 1958, at which counsel for petitioners and respondent were present, and petitioners filed an amended computation. After due consideration, it appearing that the amended computation filed by the petitioners is consonant with the determination of the Court and that the computation filed by the respondent is not, the petitioners' amended computation is approved, and it is

Ordered and Decided: That there are deficiencies in income tax for the years 1950 and 1951 in the respective amounts of \$13,191.52 and \$13,048.12.

[Seal]

s/ NORMAN O. TIETJENS.

Judge.

Entered: February 7, 1958.

Served: February 10, 1958.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME

In computing net income there shall be allowed as deductions:

* * * *

(1) [as amended by Sec. 121(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:)

SEC. 29.23(1)-1. *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggre-

gate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. Due regard must also be given to expenditures for current upkeep. * * *

SEC. 29.23(1)-2. Depreciable Property.—The necessity for a depreciation allowance arises from the fact that certain property used in the business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, or to land apart from the improvements or physical development added to it. It does not apply to bodies or minerals which through the process of removal suffer depletion, other provisions for this being made in the Internal Revenue Code. (See sections 23(m) and 114.) Property kept in repair may, nevertheless, be the subject of a depreciation allowance. (See section 29.23(a)-1.) The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income. No such allowance may be made in respect of automobiles

or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, or in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

* * * *

SEC. 29.23(1)-4. Capital Sum Recoverable Through Depreciation Allowances.—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113(a) and 114.) To this amount should be added from time to time the cost of improvements, additions, and betterments, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. (See section 113(b).) * * *

SEC. 29.23(1)-5. Method of Computing Depreciation Allowance.—The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or

other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed.

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. * * *

* * * *

**In the
Supreme Court of the United States**

No. 143

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

ROBLEY H. EVANS and JULIA M. EVANS,

Respondents.

**MEMORANDUM FOR ROBLEY H. EVANS AND
JULIA M. EVANS, RESPONDENTS**

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**In the
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**MEMORANDUM FOR ROBLEY H. EVANS AND
JULIA M. EVANS, RESPONDENTS**

By reason of the conflict between the decision of the Court of Appeals for the Ninth Circuit herein and the decision of the Court of Appeals for the Third Circuit in *The Hertz Corporation (successor by merger to J. Frank Connor, Inc.) v. United States of America*, (59-2 USTC Para. 9560, July 6, 1959), and because the issues involved in both cases are of substantial and continuing importance,

we agree that review by this Court of the *Evans* decision is warranted and that the petition for certiorari herein should be granted.

Respectfully submitted,

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No. 148

In the Supreme Court of the United States

OCTOBER TERM, 1959

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ROBLEY H. EVANS AND JULIA M. EVANS

**ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT**

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

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No. 143

COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

v.

ROBLEY H. EVANS AND JULIA M. EVANS.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF
APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 24-33) are not officially reported. The opinion of the Court of Appeals (R. 101-119) is reported at 264 F. 2d 502.

JURISDICTION

The judgment of the Court of Appeals was entered on January 26, 1959. (R. 120.) On April 23, 1959, by order of Mr. Justice Douglas, the time within which to petition for a writ of certiorari was extended to and including June 25, 1959. (R. 120-121.) The petition was filed on June 25, 1959, and the writ was granted on October 12, 1959, 361 U.S. 812. (R. 121.) The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTION PRESENTED

The taxpayer is in the business of leasing automobiles to a corporation which in turn leases and rents automobiles to the public. Because the corporation's customers demand late-model automobiles, taxpayer customarily sells his automobiles before the end of their physical life for a substantial price. The question, relating to the "reasonable" allowance for depreciation authorized by Section 23(1) of the Internal Revenue Code of 1939, is whether the leased automobiles are depreciable (as the Commissioner contends) on the basis of their estimated useful life in the taxpayer's business, using a depreciation base consisting of cost less the substantial resale value of the automobiles at the end of their useful life in taxpayer's business, rather than (as the court below held) on the basis of the longer physical life of the automobiles, with cost less salvage value at the end of their physical life as the depreciation base.*

STATUTE AND REGULATIONS INVOLVED

Sections 23(1) and 3791 (a) and (b) of the Internal Revenue Code of 1939, and Sections 29.23(1)-1, 29.23(1)-2, 29.23(1)-4 and 29.23(1)-5 of Treasury Regulations 111 are set forth in Appendix A, *infra*, pp. 36-39.

STATEMENT

This case concerns the allowance for depreciation of certain automobiles for the taxable years 1950 and 1951. The facts, which were stipulated in part (R. 20-24), were found by the Tax Court as follows:

* The question is presented in concrete, and perhaps more understandable, form by the illustrative example stated in footnote 6, page 14, *infra*.

The taxpayers, Robley H. Evans and Julia M. Evans, are husband and wife residing in the State of Washington. During the taxable years 1950 and 1951, Robley H. Evans (hereafter called the taxpayer) was engaged in the business of leasing automobiles in the vicinity of Seattle. During 1950 and 1951, he leased all of his automobiles to Evans U-Drive, Inc., a corporation, at the rate of \$45 per month per automobile. The leasing agreement between taxpayer and U-Drive provided that taxpayer would furnish and lease to U-Drive a sufficient number of automobiles to operate and conduct efficiently an automobile rental business. Taxpayer retained title to the automobiles and had the right to sell and dispose of any of the automobiles at any time. U-Drive agreed to pay all expenses of maintenance and repair of the automobiles and also to keep them insured against liability for personal injury or property damage. U-Drive also assumed the risk of loss or damage. U-Drive engaged in two types of activity during the taxable years. It leased about thirty to forty percent of its automobiles to customers for long periods of time, eighteen to thirty-six months, and it rented the remainder of its automobiles to the general public on a short-term basis, for a few hours, a few days or a few weeks. (R. 26-27.)

Taxpayer normally kept a supply of automobiles on hand which he purchased new from local automobile dealers, usually at the factory price. He endeavored to maintain a modern fleet of rental automobiles as

U-Drive was organized in 1949. All of its outstanding stock was held by taxpayer's son until near the end of 1951 at which time taxpayer acquired a portion of the stock. Taxpayer was the manager of U-Drive. (R. 26.)

this was necessary to meet the demands of U-Drive's leasing and rental business. Periodically, he owned more automobiles than were necessary for the efficient operation of U-Drive's short-term rental business. When this situation occurred, he would examine the cars in use and would sell those that were not needed. The oldest and least desirable automobiles were sold first. When sold, they usually had been driven an average of 15,000 to 20,000 miles and were generally in good mechanical condition. Many automobiles were sold at the end of the tourist season, after Labor Day. At the termination of U-Drive's extended-period leases, the automobiles would be returned to taxpayer who would sell them. When sold, they might have been driven up to 50,000 miles. They were usually in good mechanical condition and state of repair at the time of sale. (R. 27-28.)

The surplus automobiles sold by taxpayer could have been used longer than they were; however, customers of U-Drive demanded late-model automobiles that were currently in style. Older automobiles did not have much value as rental vehicles. During the taxable years, taxpayer sold the automobiles used by U-Drive in the short-term rental phase of its business after they had been used about fifteen months. And he usually sold the automobiles which had been leased for extended periods as soon as the lease was terminated. If a new lease was executed, a new car was usually provided for the lessee. Taxpayer sold most of his automobiles to used car dealers, jobbers or brokers. As a general rule, the cars were sold at current wholesale prices. Taxpayer did not adver-

tise the sales nor did he maintain a showroom or any other retail facilities for sale of his surplus automobiles. (R. 28.)

Taxpayer's returns for 1950 and 1951 disclosed that he sold 140 and 147 automobiles, respectively, in those years. The average cost, sales price, depreciation claimed, and gain per automobile were approximately as follows:

Year	Cost	Sales price	Depreciation claimed	Gain
1950	\$1,650	\$1,386	\$515	\$245
1951	1,495	1,395	450	350

Most of the automobiles sold had been held by taxpayer less than fifteen months. On his returns, taxpayer claimed depreciation on the automobiles he leased to U-Drive in amounts computed on the basis that the automobiles had an estimated useful life of four years, with no salvage value at the end of the four-year period. (R. 28-29.)

The Commissioner recomputed the allowable depreciation on the theory that, for purposes of depreciation, useful life means the useful life of an asset in the particular taxpayer's business, which may, as in this case, be shorter than physical life; and that salvage value is not limited to the scrap or junk value of the asset, but may be (as here) the substantial resale value remaining in the asset at the time it proves no longer useful in the particular taxpayers' business. On this basis, the Commissioner estimated the useful life of taxpayer's automobiles to be seventeen months and the salvage value \$1,325 at the end of that period (or the amount of unde-

preciated cost at January 1, 1950, for automobiles in use at that date, if less than \$1,325). (R. 29, 103-104.)

The Tax Court accepted the Commissioner's view of useful life and salvage value, but made separate findings as between the short-term and extended-term rental cars. (R. 29-30.) The Tax Court found that the automobiles leased to U-Drive during the taxable years for use under extended-term leases had a useful life of three years and a salvage value of \$600. However, if the undepreciated cost of such automobiles in service at January 1, 1950, is less than \$600, then that amount is to be taken as the salvage value of those automobiles. It also found that the automobiles leased to U-Drive during the taxable years for short-term rental use had a useful life of fifteen months and a salvage value of \$1,375. However, if the undepreciated cost of such automobiles in service at January 1, 1950, is less than \$1,375, then that amount is to be taken as the salvage value. (R. 29-30.)

Upon taxpayer's appeal, the Court of Appeals reversed and remanded, holding that the Tax Court had erred when it measured useful life of the automobiles by the period during which they were held in the business of taxpayer, instead of the physical or economic life of these assets, and that the application by the Tax Court of an erroneous concept of "useful life" necessarily required a redetermination by the Tax Court of "salvage value." The Court of Appeals pointed out that the Tax Court had determined salvage value to be the estimated proceeds which

would be realized from the automobiles when they were no longer useful in taxpayer's business rather than the estimated proceeds which would be realized upon the sale or other disposition of these assets at the end of their physical or economic life. In remanding, the Court of Appeals directed that the period over which useful life—meaning the physical or economic life—extends and the salvage value at the end of such period be determined by the Tax Court.² (R. 115.)

SUMMARY OF ARGUMENT

Taxpayer, who is engaged in the car rental business, retains cars for a relatively short period (in the case of most vehicles, approximately fifteen months) and then disposes of them by sale, receiving, on the average, a price which does not fall far short of original cost. Since this taxpayer is not deemed to be primarily engaged in the business of selling automobiles, the vehicles, for tax purposes, are depreciable capital assets rather than ordinary stock in trade. This case concerns the method of depreciation which may properly be employed in relation to these assets.

The allowance for depreciation is designed to return to a taxpayer, tax-free, the cost of his capital asset over the period that it is useful to the taxpayer in his business. The amount of the allowance, as Mr. Justice Brandeis stated for the Court in *United States v. Ludey*, 274 U.S. 295, 300-301, "is the sum which should

² In this connection the court below noted (R. 115), "We do not agree with the petitioner's [taxpayer's] contention that the value remaining in such assets at the end of their physical or economic life necessarily means scrap or junk-value."

be set aside for the taxable year, in order that, at the end of the useful life of the [asset] in the business, ~~the aggregate of~~ the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost."

Consistently with this classic statement of the rule, the Commissioner has taken the position that taxpayer should depreciate its automobiles over the period during which (according to best estimate) they will be used in taxpayer's business. This means that the taxpayer should (1) ascertain the probable salvage value as of the conclusion of the anticipated holding period; (2) subtract that salvage value from original cost; and (3) apportion the resulting figure over the period in question according to a reasonably consistent plan.

Taxpayer, on the contrary, urges that he may depreciate the cars *as if* he were going to retain them for their entire economic life. Proceeding on this contrary-to-fact assumption, taxpayer assumes further that salvage value need play no role (or at most a negligible one) in the computation.

The view that useful life, for purposes of computing depreciation, means useful life in the taxpayer's business (and not the period during which the asset may prove useful to someone) is supported by decisions of this and other courts (including the decisions of the Third and Fifth Circuits in the closely related *Hertz* and *Massey* cases, now pending before this Court, Nos. 283 and 141, respectively). It finds consistent expression, over a long period of years, in the regulations and other authoritative pronouncements of the

Treasury. Congress, moreover, used the phrase "useful life" in the same sense when it employed it, for the first time, as a statutory term in the 1954 Code—a factor which is significant (although the tax years here involved are 1950 and 1951) because Congress was making no change in the settled concept of depreciation.

By proceeding on the false premise that he will use the cars for the duration of their economic life (whereas, in fact, they are used for relatively short periods), taxpayer finds it possible to ignore the circumstance that he receives very substantial sums (representing, in 1950, more than 80 percent and, in 1951, more than 90 percent of original cost) upon their resale. Having effectively shunted salvage value from the picture and, having thus eliminated the natural ceiling which it imposes upon claims for depreciation, taxpayer takes depreciation in amounts substantially greater than would otherwise be available. Since depreciation is a deduction from ordinary income, income taxes are thereby reduced. It is true, to be sure, that the inflation of depreciation reduces, *pro tanto*, the cost basis of the asset, and to that extent, increases the liability for capital gains. Capital gains are taxed, however, at more favorable rates.

The Commissioner's position not only accords with the authorities—the decisions and regulations; it is also in accord with reasonable practice and with common sense. Significantly, an important segment of the automobile leasing industry (the companies represented by the American Automotive Leasing Association) has expressly acknowledged that depreciation

on automobiles should be taken by car rental firms on the basis of the period during which it is estimated that such assets will be used in the leasing business. The Association has disavowed practices which would "permit the leasing industry to be used as a device or a gimmick to convert ordinary income into capital gains."

ARGUMENT

USEFUL LIFE, FOR PURPOSES OF DEPRECIATION, IS THE PERIOD DURING WHICH AN ASSET IS USEFUL TO THE TAXPAYER IN HIS BUSINESS AND SALVAGE VALUE IS THE AMOUNT WHICH MAY REASONABLY BE EXPECTED TO BE RECEIVED FROM THE SALE OF THE PROPERTY AFTER IT HAS LOST ITS UTILITY IN SUCH BUSINESS

A. INTRODUCTION

Taxpayer is in the car rental business. Because of the nature of his business operation, he regularly disposes of cars employed in the business at a time when the vehicles are still in good and usable condition. Under Section 117 of the Internal Revenue Code of 1939 (26 U.S.C., 1952 ed., Section 117), capital gain rates are available with respect to certain property used in the taxpayer's business, but not available with respect to "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."³ The Commissioner does not contend that the taxpayer here holds his automobiles primarily for sale. Concededly, if tax-

³ Under Section 117(j) of the 1939 Code and the comparable successor provision of the 1954 Code (26 U.S.C., 1958 ed., Sec. 1231), gain realized on the sale of depreciable assets used in a trade or business (but not held primarily for sale) and held for more than six months is taxable as capital gain.

payer, after holding a car for a period of time and employing it in the rental business, sells that car at a gain, the gain is entitled to treatment as a capital gain. The question in this case bears upon the proper computation or determination of capital gain. More particularly, it involves the proper method of taking depreciation as a deduction from ordinary income—depreciation being directly relevant to capital gain determination since every dollar taken by way of depreciation is subtracted from the cost basis of the property. For example, if depreciation is taken in inflated amounts, capital gain is artificially enhanced (because the cost basis of the property is artificially lessened). By the same token, in such a case ordinary income is artificially (and correspondingly) lowered, since depreciation is chargeable against business income. The Government contends in this case, as will appear below, that depreciation is being taken by the taxpayer on an unrealistic basis; that this approach artificially reduces ordinary income and enhances capital gain; and that it produces the end consequence that income which should be taxed at ordinary rates is ultimately taxed at the more favorable rates applicable to capital gains.⁴

Section 23(1) of the Internal Revenue Code of 1939 (Appendix A, *infra*, p. 36) and Section 167(a) of the Internal Revenue Code of 1954 (Appendix B, *infra*, p. 40) provide for a depreciation deduction of—

⁴The same general problem is also presented in *Massey Motors, Inc. v. United States*, No. 141, and *Hertz Corp. v. United States*, No. 283, which are being argued together with this case.

A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

- (1) of property used in the trade or business, or
- (2) of property held for the production of income.

Generally, several factors must be taken into account in the determination of allowable depreciation—(1) whether the property is depreciable in the first instance, (2) the cost or other basis to be recouped through the depreciation allowance, (3) the period of time over which this recoupment is to be made (the “useful life” of the property), and (4) the estimated value of the property which can be expected to be recovered on the sale or other disposition of the property at the end of its useful life (the “salvage value” of the property). No problem is presented in this case (or in the *Hertz* and *Massey* cases) as to the cost or other basis to be recovered through the deduction for depreciation and we concede that the property is depreciable. We are concerned exclusively with the “useful life” of the property and with its salvage value.

Briefly stated, the taxpayer's position, which was upheld by the Court of Appeals, is that the “useful life” of the property is ascertained by discovering the period during which the property can be expected to be economically useful in any business (approximating its expected physical life) and “salvage value” is to be limited to scrap or junk value. The high salvage (or resale) value to taxpayer—what

taxpayer will predictably realize upon resale following a relatively short holding period—is thus shunted from the picture so that taxpayer may “assume” a depreciation which he knows, upon the basis of his practice, his plan and his experience, will not occur.

The Commissioner's position, on the other hand, is that “useful life” is that period during which the property involved can reasonably be expected to be useful in the business of the particular taxpayer involved, that is, useful for the purpose for which the particular taxpayer acquired the property. Salvage value, under our view, would be that amount which the particular taxpayer could reasonably expect to receive on the sale or disposition of the property at the point that it has lost its utility in his business. In many instances, of course, the period of general economic utility of an asset will coincide with the period during which the particular taxpayer can reasonably expect to use the asset. It is only in cases such as the one at bar, where because of the peculiar nature of the business the asset must be replaced while it is still generally usable, that the definition of “useful life” becomes important.³

³ Although the court below stated (R. 115) that it did not agree with taxpayer's contention that the value remaining in the automobiles at the end of their physical or economic life necessarily means scrap or junk value and left this question, as well as the physical or economic life of the assets, to be determined by the Tax Court on remand, it seems plain that the salvage value of the cars at the end of the period during which they are useful to taxpayer in his business far exceeds any value they may be found to possess at the end of their physical life.

We shall urge that only by adopting the Commissioner's approach—an approach which has been accepted by the Courts of Appeals for the Third and Fifth Circuits in *Hertz Corp. v. United States*, 268 F. 2d 604, and *United States v. Massey Motors*, 264 F. 2d 552—can the depreciation deduction fulfill the purpose for which it is intended. The approach of the court below results, in our view, in a distortion of the basic concept and purpose of depreciation; and it thereby permits the depreciation deduction to serve as a ready and convenient device for converting ordinary income into capital gain.⁶

⁶ It may be useful to point out, purely in terms of practical monetary consequences, how the differences in legal theory may affect tax liability. The following illustration (in which we use hypothetical facts and figures for the sake of simplicity) is offered for this purpose:

Cost of car to taxpayer.....	\$1,600
Sales price of car upon disposition by taxpayer at end of one year.....	1,500
Depreciation based upon four years' "useful life" and no salvage value (taxpayer's theory).....	400
Depreciation based on one year's "useful life" in taxpayer's business and limited by salvage value of \$1,500 (Commissioner's theory).....	100

As shown above, taxpayer's theory, applied to the hypothetical case, results in \$400 depreciation. (Depreciation, of course, is chargeable against ordinary income.) It also results in a capital gain of \$300: Resale price of \$1,500 less adjusted basis of \$1,200 (original cost of \$1,600 less \$400 in depreciation) equals \$300.

The Commissioner's theory, on the other hand, yields a depreciation figure of \$100 and no capital gain or loss (since the resale price is \$1,500 and the adjusted cost basis is also \$1,500).

The practical difference between the two computations, then, is that the taxpayer's theory yields \$300 more depreciation

B. THE STATUTORY PURPOSE UNDERLYING AN ALLOWANCE FOR DEPRECIATION AND THE CONSISTENT ADMINISTRATIVE PRACTICE SUPPORT THE CONCLUSION THAT THE "USEFUL LIFE" OF A DEPRECIABLE ASSET IS THAT PERIOD DURING WHICH THE ASSET CAN REASONABLY BE EXPECTED TO BE USED IN THE BUSINESS OF THE PARTICULAR TAXPAYER INVOLVED

1. The justification for a depreciation allowance is essentially simple—that an investment in a business asset subject to wear and tear should be deducted from taxable income over the course of that period during which the asset is productive in taxpayer's business, so that through such deductions (together with salvage value) he may recover, for tax purposes, his capital investment in the asset. This theory has been many times recognized by this Court as the underlying basis for the depreciation deduction. For example, in *United States v. Ludy*, 274 U.S. 295, 300-301, the Court, per Brandeis, J., said:

The depreciation charge permitted as a deduction from the gross income in determining the taxable income of a business for any year represents the reduction, during the year, of the capital assets through wear and tear of the plant used. The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost. The theory

(hence, \$300 less in ordinary income and \$300 more in capital gain) than the Commissioner's. Changing the figures will not alter the principle: to whatever extent depreciation is enhanced, the cost basis of the capital asset is correspondingly reduced.

underlying this allowance for depreciation is that by using up the plant, a gradual sale is made of it. * * *

Again, in *Detroit Edison Co. v. Commissioner*, 319 U.S. 98, 101, this Court stated:

It will be seen that the rule applicable to most business property of a cost basis properly adjusted leaves many problems of depreciation accounting to be answered by sound and fair tax administration. The end and purpose of it all is to approximate and reflect the financial consequences to the taxpayer of the subtle effects of time and use on the value of his capital assets. For this purpose it is sound accounting practice annually to accrue as to each classification of depreciable property an amount which at the time it is retired will with its salvage value replace the original investment therein. * * *

See also *Gambrinus Brewery Co. v. Anderson*, 282 U.S. 638, 643; *Virginian Hotel Co. v. Helvering*, 319 U.S. 523, 528; *Cohn v. United States*, 259 F. 2d 371, 377 (C.A. 6th); *Becker v. Anheuser-Busch*, 120 F. 2d 403, 412 (C.A. 8th), certiorari denied, 314 U.S. 625; *Burlington Gazette Co. v. Commissioner*, 75 F. 2d 577, 578 (C.A. 8th); *Cameron v. Commissioner*, 56 F. 2d 1021, 1023 (C.A. 3d). See also Treasury Regulations on Income Taxes (1954 Code, Section 1.167(b)-1) (Appendix B, *infra*, p. 42).

The only way in which the depreciation allowance can be made to effectuate this declared purpose is by adopting the view urged herein—that depreciation must be computed by using a rate determined by the expected useful life of the asset in the taxpayer's

business and by taking into account an estimate of salvage value at the end of that period. One cannot properly adopt a technique whereby depreciation for the period that the property is held will regularly exceed the difference between the cost of the depreciable asset and its reasonably anticipated salvage value at the conclusion of the anticipated holding period. If salvage value should exceed reasonable expectation—if, for example, the value of used cars should suddenly increase as a result of wartime conditions—realization of capital gain would not show that the method of computing depreciation was impermissible. Our point is that a correct plan or technique of depreciation will not consistently produce capital gains in an ordinary or stable market.

In the instant case, one finds that the taxpayer claimed depreciation in 1950 (per average car) of \$515. In 1951, the figure was \$450. In contrast, the sales price of the average car at the time it ceased to be useful in the business was \$270 less than original cost in 1950 and \$100 less than original cost in 1951.

In *Massey*, the facts are even more striking. There, it appears, the cars were sold by the taxpayer, at the end of the holding period, for amounts in excess of original cost. Taxpayer nonetheless claimed substantial depreciation, urging that "useful life" means physical life (regardless of the period of time that taxpayer intends to hold the property) and that no salvage value would remain thereafter. Rejecting this approach, the Court of Appeals concluded (264 F. 2d at 558) "that as to a taxpayer so placed

that his business experience has taught him that automobiles * * * with use in the business averaging less than one third of their total usable life can then be sold at substantially the original cost to him, such automobiles are depreciable by him on the basis of his expected use of the cars in his business and not on the basis of the length of time the car is expected to be usable as a passenger automobile."

The *Hertz* case is still more extreme. There, taxpayer claimed depreciation under the declining balance method at double the straight line rate. Although such accelerated depreciation is available only with respect to assets having a useful life of three years or more, the taxpayer sought to avail itself of this method by contending that its automobiles had a useful business life of four years notwithstanding the fact that it used them only for a period slightly in excess of two years. As in *Massey*, the Court of Appeals held that "the accepted meaning of the term useful life has always been the period of usefulness of the asset to the taxpayer in his business" (268 F. 2d at 609). The court also rejected the notion (*ibid.*) that one may adopt a technique of depreciation calculated "to depreciate the asset below a reasonable salvage value."

In order to ignore salvage value, taxpayer must base his depreciation not on the experience of his business, but on an artificial assumption, contrary to fact, that he uses cars for their full physical life, allegedly four years. The statute prescribes a "reasonable allowance" for depreciation for the particular taxpayer involved and it is his invest-

ment, not that of some possible successor in title (which might, and probably would, be different), that is to be recovered through the depreciation deduction. This can only be accomplished by measuring the period during which depreciation is to be allowed by the time during which the asset is expected to be useful to the particular taxpayer and estimating a salvage value at the end of that period. This is not to contend for a hindsight determination of the actual period of usefulness to the taxpayer or of salvage value. Rather, the estimates of useful life and salvage value should be made at the time of acquisition of the asset.⁷ These estimates should be based on the past experience of the taxpayer and a reasonable prediction as to whether past experience is likely to be repeated for the asset, taking into account any changed circumstances that might be relevant.

2. Almost from the inception of modern income tax law, the Treasury Regulations have expressed the same concept of depreciation which the Commissioner urges in the instant case—a concept which was accepted by this Court, in 1927, in its opinion in *United States v. Ludey, supra*. Indeed, the formulation in the *Ludey* opinion, quoted above (pp. 15–16), is almost a paraphrase of Article 161 of Treasury Regulations 65, promulgated under the Revenue Act of 1924, which read in relevant part as follows:

* * * The proper allowance for such depreciation of any property used in the trade or

⁷ Changes in circumstances could give rise to adjustments of these estimates.

business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the basis of the property * * *.

The statement was consistently repeated in later regulations.⁹ And it appeared again when the first regulations were promulgated under the Internal Revenue Code of 1939.¹⁰ During the period that regulations used language referring to the useful life of the property in the business, Congress, time and again, reenacted the provision for depreciation deduction without making any change significant for present purposes.¹¹

⁹ For other similar statements appearing in the early regulations, see Article 161 of Treasury Regulations 45 (1919 and 1920 eds.), 62 and 69 promulgated under the Revenue Acts of 1918, 1921 and 1926. A preliminary draft of the regulations under the 1918 Act, also containing similar language, was published as House Document No. 4826, 65th Cong., 3d Sess.

⁹ See Article 201 of Treasury Regulations 74 and 77, promulgated under the Revenue Acts of 1928 and 1932 and Article 23 (1)-1 of Treasury Regulations 86, 94 and 101, promulgated under the Revenue Acts of 1934, 1936 and 1938.

¹⁰ Treasury Regulations 103, Section 19.23(1)-1 (Appendix B, *infra*, p. 45).

¹¹ See Sections 214(a) (8) and 234(a) (7) of the Revenue Acts of 1918, c. 18, 40 Stat. 1057; of 1921, c. 136, 42 Stat. 227; of 1924, c. 234, 43 Stat. 253; and of 1926, c. 27, 44 Stat. 9; Section 23(k) of the Revenue Acts of 1928, c. 852, 45 Stat. 791, and of 1932, c. 209, 47 Stat. 169; Section 23(1) of the Revenue Act of 1934, c. 277, 48 Stat. 680; of 1936, c. 690, 49 Stat. 1648; and of 1938, c. 289, 52 Stat. 447; Section 23(1) of the Internal Revenue Code of 1939.

Taxpayer has relied in this litigation upon a change in the regulations which took place shortly after the enactment of the Revenue Act of 1942. Treasury Regulations 111 (October, 1943), Section 29.23(1)-1¹² (Appendix A, *infra*, p. 37), state:

A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. * * * The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the *depreciable property*, equal the cost or other basis of the property determined in accordance with section 113. * * * [Emphasis added.]

The explanation of the change is cogently stated in the Fifth Circuit's opinion in the *Massey* case. Referring to the language quoted immediately above, that court observed (264 F. 2d at 557):

It will be apparent that in the last sentence the words "property in the business" have been eliminated and the words "depreciable property" substituted. A cursory look at the legislative history back of this amendment clearly demonstrates that there was no purpose to express a change in what was meant by useful

¹² See, also, the amendment of Treasury Regulations 103, Section 19.23(1)-1 (T.D. 5196, 1942-2 Cum. Bull. 96, 100, December 1942).

life. This change was necessitated by an amendment in 1942 to the 1939 Code, which *added* as property entitled to depreciation "property held for the production of income." Thus the regulation which had theretofore dealt only with property used in the trade or business was inadequate, and it had to be amended by the inclusion of the italicized words above. The last sentence could not, of course, thereafter adequately cover both classes of property by referring to "property in the business" because this would not include the new class "property held for the production of income." The language "depreciable property" would, of course, cover both, and it was substituted for "property in the business."¹³¹

Thus, we think it clear that whatever was understood by the Treasury Department prior to 1942 by useful life remained unchanged by the amendments here discussed.¹³⁴

The statutory change noted in the quotation was made by the enactment of Section 121(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798, which amended Section 23(1) of the 1939 Code.

¹³¹ The court below construed the words "in the business" in the prior regulations to have "simply defined the type of assets which were subject to the depreciation allowance." (R. 109.) Section 19-23(1)-2 of Treasury Regulations 103 (the first Regulations promulgated under the 1939 Code), however, specifically defined the type of assets which were subject to the depreciation allowance. In view of the fact that a specific detailed definition of depreciable property was contained in Section 19-23(1)-2, the use of the words "in the business" in Section 19-23(1)-1 undoubtedly was intended to have a function other than that of mere definition. And this function, we submit, was to limit the concept of "useful life" to that time dur-

The court below was of the view (see R. 111-113) that a guide to taxpayers issued by the Internal Revenue Service—a publication known as Bulletin “F” (Revised January 1942) dealing with depreciation and setting out average rates by which to measure the useful life of various types of property—indicated that the Commissioner did not “consider that the useful life of an asset was to be measured by the estimated holding period of such asset by the taxpayer” (R. 113). The Fifth and Third Circuits drew the contrary inference in the *Massey* and *Hertz* cases. 264 F. 2d at 557-558; 268 F. 2d at 608.

The opinion in the instant case refers to language in the Bulletin which stated that assets used in the production of income are gradually worn out, exhausted or consumed over a period of years and that the period over which depreciation extends is the normal useful life. But there is no reason to suppose that this passage contemplated anything other than the normal situation in which the asset is worthless for business purposes after the period of use by the taxpayer. Indeed, this is made abundantly clear by other statements appearing in Bulletin “F”. Thus, on the title page of Bulletin “F”, the following appears:

ing which the property was useful “in the business” of the taxpayer.

For a comprehensive article discussing the general problem here involved and supporting our position that the regulations have always defined the useful life of an asset in terms of its expected usefulness in the taxpayer's business, see Kirby, *Accelerated Depreciation and the Treasury Regulations*, 54 Northwestern Law Review 434 (September-October 1959).

Taxpayers and officers of the Bureau are cautioned against reaching conclusions in any case solely on information contained herein and should base their judgment on the application of all pertinent provisions of the law, regulations, and other Treasury Decisions *to all the facts in any particular case.* The *estimated useful lives* and rates of depreciation indicated in this bulletin *are based on averages and are not prescribed for use in any particular case.* They are set forth solely as a guide or starting point from which *correct rates may be determined in the light of the experience of the property under consideration and all other pertinent evidence.* [Emphasis added.]

Again, on page 2, Bulletin "F" reads:

The proper allowance for exhaustion, wear and tear, including obsolescence, of property used in trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate) whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of *the useful life of the property in the business*, equal the cost or other basis of the property. In no instance may the total amount allowed be in excess of the amount represented by the difference between the cost or other allowable basis and the salvage value which reasonably may be expected to remain at the end of the useful life of the property in the trade or business. [Emphasis added.]

And it is further stated (p. 7):

Salvage value is the amount realizable from the sale or other disposition of items recovered when property has become no longer *useful in the taxpayer's business* and is demolished, dismantled, or retired from service. When reduced by the cost of demolishing, dismantling, and removal, it is referred to as net salvage. In principle, the estimated net salvage should serve to reduce depreciation, either through a reduction in the basis on which depreciation is computed or a reduction in the rate. * * * [Emphasis added.]

Although this case involves the tax years 1950 and 1951, the 1954 Code and its legislative history are significant to the extent that they reveal Congress' understanding of the depreciation concept and of the prior prevailing practice.

In the 1954 Code, Congress, for the first time, used the term "useful life" in the statutory provisions relating to depreciation. Section 167(c), Appendix B, *infra*, p. 41. The accompanying House Report (H. Rep. No. 4337, 83d Cong., 2d Sess., p. 22) stated:

Depreciation allowances are the method by which the capital invested in an asset is recovered tax-free over the years it is used in a business. The annual deduction is computed by spreading the cost of the property over its estimated useful life. * * *

This statement, of course, supports our view of the depreciation concept. What is more, Congress was

of the opinion that it was making no change in the prevailing concept. Thus the Report goes on to state (H. Rep. No. 1337, *supra*, p. 25) that "The changes made by your committee's bill merely affect the timing and not the ultimate amount of depreciation deductions with respect to a property."

It is notable that regulations under the 1954 Code defining salvage value (Treasury Regulations on Income Taxes (1954 Code), Section 1.167(a)-1(c), Appendix B, *infra*, pp. 43-44) paraphrase the definition of salvage value (quoted *supra*, p. 25) which had long appeared in Bulletin "F". The court below concedes that under the current regulations useful life is the period over which the asset may be expected to be useful in the taxpayer's business. Yet, inconsistently, that court views Bulletin "F" as manifesting a contradictory past practice.¹⁵ We submit that,

¹⁵ In order to support its conclusion as to the proper interpretation of the regulations and of Bulletin "F," the Court of Appeals also referred (R. 113) to decisions of the Board of Tax Appeals and the Tax Court as indicating that the general economic or physical life of an asset was determinative in establishing a depreciation rate. *West Virginia & Pennsylvania Coal & Coke Co. v. Commissioner*, 1 B.T.A. 790; *James v. Commissioner*, 2 B.T.A. 1071; *Kay v. Commissioner*, 10 B.T.A. 534; *Foster v. Commissioner*, decided August 4, 1943 (1943 P-H T.C. Memorandum Decisions, par. 43,373); *Maguire Estate v. Commissioner*, 17 B.T.A. 394; *Lewis v. Commissioner*, decided December 27, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,339); *Whitman-Douglas Co. v. Commissioner*, 8 B.T.A. 694; *Sanford Cotton Mills v. Commissioner*, 14 B.T.A. 1210; *Merkle Broom Co. v. Commissioner*, 3 B.T.A. 1084; *Kurtz v. Commissioner*, 8 B.T.A. 679. An examination of these cases shows that each was considered on its own facts and that no generalizations were

in the words of the Third Circuit (*Hertz* case, 268 F. 2d at 609), "the accepted meaning of the term useful life has always been the period of usefulness of the asset to the taxpayer in his business."

C. THE TAXPAYER'S METHOD OF COMPUTING DEPRECIATION IN THE ABSTRACT, WITHOUT REGARD TO THE USEFUL LIFE OF THE PROPERTY IN HIS BUSINESS, RESULTS IN A DISTORTION OF INCOME AND PROVIDES A CONVENIENT METHOD FOR CONVERTING INCOME OTHERWISE TAXABLE AS ORDINARY INCOME INTO CAPITAL GAIN

The primary purpose of any system of accounting is to reflect clearly the income of the business for the accounting period. This is true whether the system is designed to compute income for tax purposes or for general accounting purposes. No method of accounting should suffice for either purpose if it results in a distortion of the income for the accounting period.

As argued above, the basic purpose of the depreciation allowance is to permit the taxpayer to recover his capital investment in the property being depreciated, taking into account its estimated salvage value. Another way of viewing the depreciation allowance, consistent with that purpose, is to consider the entire capital investment in the depreciable asset as an expense or cost paid in advance. This cost should properly be allocated over the productive life of the

intended as to the question of "useful life." As the Third Circuit concluded in *Hertz* with respect to these cases (268 F. 2d at 608):

"the issue was not squarely presented nor was any theory of useful life formulated therein; rather, the questions posed in the cases were treated as factual in nature. Thus they are of little, if any, use to us as precedents."

property in the business by depreciation deductions. In that manner, the cost of the asset is spread over the period of use and the gross income produced by the asset is reduced by so much of the cost as was incurred in producing the income. This Court stated the point in *Gambrinus Brewery Co. v. Anderson*, 282 U.S. 638, 642-643, as follows:

The cost of plant depreciation, i.e., exhaustion, wear, tear and obsolescence, is a part of operating expenses necessary to carry on a manufacturing business. The gain or loss in any year cannot be rightly ascertained without taking into account the amount of such cost that is justly attributable to that period of time.

When the instant case is examined in this light, the distortion of income resulting from taxpayer's method of depreciation becomes apparent. Thus taxpayer, in a period of fifteen months, has claimed depreciation deductions totaling \$515 on an automobile the cost of which is \$1,650, leaving a depreciated cost basis of \$1,135. At the end of such fifteen-month period, the automobile is sold for \$1,380 for a net gain of \$245.¹⁶

¹⁶ Putting it another way, as the District Court did in the *Hertz* case (165 F. Supp. 261, 269, fn. 6), the transaction may be analyzed as follows:

Cost-----	\$1,650.00
Depreciation (fifteen months)-----	515.00
Basis at time of sale-----	1,135.00
Sale price-----	1,380.00
Long-term capital gain-----	245.00
Tax on gain (not more than 25 percent)-----	61.25

(R. 29, 103.) This is not a recovery of cost or investment but a means of creating profits taxable at capital gains rates.

To the extent that this increased depreciation lowers the basis for the automobile, the taxpayer, of course, has an increased gain on the disposition of the car. But this, we submit, cannot answer the objections to this distortion of income, since the gain on sale is taxable as capital gain and not ordinary income. The result, if taxpayer is correct, is that through the medium of the depreciation deduction ordinary income can easily be converted into capital gain. On the other hand, if, as the Commissioner contends, the depreciation deduction must be based upon a rate determined by the period during which the asset can reasonably be expected to be used in the taxpayer's business and a reasonable estimate of salvage value at the end of that period, there will be no conversion of ordinary income into capital gain. Ordinary and predictable salvage value, determined as of the time that sale of the asset is contemplated, will impose a realistic ceiling upon depreciation claims.¹⁷

Net gain after taxes.....	\$183.75
Recovery through depreciation.....	515.00
Recovery of remaining basis through sale.....	1,380.00
<hr/>	
Total recovery.....	2,078.75
Gain to taxpayer over original cost.....	428.75

And see the illustration set out in note 6, p. 14, *supra*.

¹⁷ That proposals were made to Congress that there should be no capital asset treatment from gains on sales of depreciable assets and that such proposals were not adopted by Congress is no answer to the proposition that the depreciation deduction was not intended to allow taxpayers to convert ordinary income into capital gain.

The opinion below refers (R. 114-115) to the expert testimony of two accountants who testified as witnesses for taxpayer in the proceedings before the Tax Court. The import of their testimony was that "useful life" invariably means physical or economic life and that "salvage value" means junk value. Commenting on similar expert testimony which had been offered in the *Hertz* case, the Third Circuit pointedly observed (268 F. 2d at 608-609) that the standard work on tax accounting, edited by four partners in the accounting firm of Lybrand, Ross Bros. & Montgomery, is directly to the contrary. *Montgomery's Federal Taxes* (37th ed. (1958)), c. 6, p. 4.

Common sense dictates the conclusion that salvage value ought not be treated as junk value when the taxpayer knows that he is going to obtain his salvage (resale price) at a time when the depreciable asset is in eminently good condition and still retains the major portion of its economic life.

Perhaps, the most telling indication that the approach urged by the Government accords with common sense and reasonable business practice is that an important segment of the automotive leasing industry has openly acknowledged its correctness.

A recent case decided by the Tax Court, *Hillard v. Commissioner*, 34 T.C. 961, determined that a certain car rental firm which leased and thereafter sold its vehicles held those vehicles with a primary purpose of selling them in the ordinary course of business—a conclusion which meant that any gain realized from the sale of the vehicles was taxable under Section

117(j) of the 1939 Code as ordinary income. Upon taxpayer's appeal of that case to the Court of Appeals for the Fifth Circuit (where the case is now *sub judice*), a brief *amicus curiae*, dated October 1959, was filed on behalf of the American Automotive Leasing Association.¹⁸ The Association comprises "about 65 percent of the long-term leasing industry in motor vehicles in the country" (Association Br., p. 8).¹⁹ In its brief, the Association argues at length that the Tax Court misunderstood the nature of the automobile leasing industry and drew an erroneous legal conclusion in holding that the car rental firm in question was also engaged in the business of selling automobiles (a point not in issue in the present litigation). Accordingly, the Association argued that when a car rental firm, employing correct accounting practices, realizes a gain from the sale of cars, it is entitled to capital gain treatment.

Significantly, however, the Association was at pains to point out that it would not suggest that a car rental firm is entitled to enhance capital gain by taking depreciation for any period other than the expected useful life of the car in the taxpayer's business. The following excerpts are from its brief:

¹⁸ A copy of the Association's brief will be filed with the Clerk of this Court and copies will be served on opposing counsel in this and the companion *Marsey* and *Hertz* cases.

¹⁹ Members of the Association lease cars for one year or more. They do not lease them a second time as used cars, but dispose of them by sale. Their aggregate investment in vehicles is approximately \$286,000,000. Association Br., pp. 7-9.

With respect to the matter of depreciation, it should be emphasized, at the outset, that the American Automotive Leasing Association in no way suggests that the business of leasing automobiles can, through the depreciation allowance, properly be used as a nice device to convert ordinary income into capital gains, to be taxed at the more favorable capital gains rates. We do urge strongly, however, that the business of leasing vehicles, when properly conducted, is a separate business which is most helpful and useful to the commercial and industrial community; that the disposition of vehicles when they are no longer useful in the leasing business is necessarily a part of that leasing business,—“a natural conclusion of a vehicle rental business cycle” (*Philber Equipment Corporation v. Commissioner*, 237 F. (2d) 129, 132 (C.A. 3, 1956);—and that if any gain over the depreciated basis of the vehicles is realized on their disposition, after they have been properly depreciated in accordance with applicable law and regulations, such gain may appropriately be reported and taxed on a capital gain basis. * * * [p. 9]

* * * * *

As has been noted, the American Automotive Leasing Association does not suggest that the business of leasing vehicles may be used to convert ordinary income into capital gains. The Association is in complete accord with the Internal Revenue Regulations on depreciation promulgated under the Internal Revenue Code of 1954 (T.D. 6182, Cum. Bull. 1956-1, '98 et

seq.) and, at the time these Regulations were being considered by the Treasury Department, the American Automotive Leasing Association submitted both written material and oral testimony in support of the Regulations as finally issued.*

*Inasmuch as the Association was not organized until 1955, its position has been expressed only with respect to the Internal Revenue Code of 1954 and Regulations thereunder. And although the case at bar arises under the Internal Revenue Code of 1939, the basic principles are essentially the same, and since they are expressed more fully and completely in the Regulations under the 1954 Code, we shall refer to those Regulations herein. See *United States v. Massey Motors, Inc.*, 264 F. (2d) 552, (C.A. 5, 1959); *The Hertz Corporation v. United States*, 268 F. (2d) 604, (C.A. 3, 1959); cf. *Robley H. Evans v. Commissioner*, 264 F. (2d) 502, (C.A. 9, 1959). All three cases are pending in the Supreme Court of the United States on petitions for writs of certiorari. [p. 10]

* * * * *

It is apparent from the foregoing that the depreciation allowance,—which essentially is designed to return to the taxpayer, tax-free, the cost of his capital asset over the period during which it is useful to the taxpayer in his business (*United States v. Ludey*, 274 U.S. 295, 300-301),—is based on estimates made in advance. If a taxpayer were a perfect prophet, there would never be either a gain or a loss on disposition of an asset when it was no longer useful in business. But the regulations recognize that no one can be a perfect prophet in making the estimates, and, accordingly, they make specific provision for the treatment of the

gains realized or the losses sustained on disposition after a "reasonable allowance" for depreciation had been taken—the gain being recognized as entitled to treatment as a capital gain. Section 1.167(a)(8), T.D. 6182, Cum. Bull. 1956-1, 103-104. [p. 11]

* * * * *

Under the law, as we have already outlined, when a leasing company puts a fleet of vehicles in service, it is entitled to depreciate those vehicles on the basis of cost less reasonably estimated salvage value at the end of the period of estimated useful life. This is the entitlement and this is the obligation, and it is immaterial whether the period of use is one year, or two years or three years. This process is to enable the company to recover, by way of its annual depreciation allowance, plus salvage, its cost or other basis in the property. For example, if vehicles costing \$2,000.00 new are used for leasing for one year, and it is reasonably estimated that the salvage value at the end of the one year period will be 70 percent of cost, or \$1,400.00, the company is entitled to depreciate the remaining 30 percent, or \$600.00, during the one year of use. If, on the other hand, the vehicles are to be used in service for a period of two years, the salvage value must be reasonably estimated as of the end of that two year period, and on the assumption that it is 50 percent of cost, or \$1,000.00, the company is entitled to depreciate the remaining 50 percent, or \$1,000.00, over the two year period. It is immaterial whether the cars are held one or two or three years or until they are junk.

In each case, the total recovery is the \$2,000.00 capital outlay. The legal principles are exactly the same regardless of the holding period, and the total recovery to the company is the same. * * * [pp. 25-26]

The Association's brief concludes (p. 43) with a disavowal of any approach which would "permit the leasing industry to be used as a device or a gimmick to convert ordinary income into capital gains." The law, we submit, provides no warrant for any such approach.

CONCLUSION

The judgment of the Court of Appeals should be reversed.

Respectfully submitted.

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APPENDIX A

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(b) [as amended by Sec. 121(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23(1).).

SEC. 3791. RULES AND REGULATIONS.

(a) *Authorization*.—

(1) *In general*.—Except as provided in section 1928(a), Cotton Futures, section 2599, Marihuana, section 2559, Narcotics, section 3176, Liquor, and section 1805, Silver, the Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this title.

(2) *In case of change in law*.—The Commissioner may make all such regulations, not otherwise provided for, as may have become necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of Regulations or Rulings*.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U.S.C. 1952 ed., Sec. 3791 (a) and (b).).

Treasury Regulations 111, promulgated October 26, 1943, under the Internal Revenue Code of 1939:

SEC. 29.23(1)-1. *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the depreciable property, equal the cost or other basis of the property determined in accordance with section 113. Due regard must also be given to expenditures for current upkeep. * * *

SEC. 29.23(1)-2. *Depreciable Property.*—The necessity for a depreciation allowance arises from the fact that certain property used in the business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income, gradually approaches a point where its usefulness is exhausted. The allowance should be confined to property of this nature. In the case of tangible property, it applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion; and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced by a new invention, or due to the inadequacy of the property to the growing needs of the business. It does not apply

to inventories or to stock in trade, or to land apart from the improvements or physical development added to it. It does not apply to bodies of minerals which through the process of removal suffer depletion, other provisions for this being made in the Internal Revenue Code. (See sections 23(m) and 114.) Property kept in repair may, nevertheless, be the subject of a depreciation allowance. (See section 29.23(a)-4.) The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business, or treated under section 29.23(a)-15 as held by the taxpayer for the production of income. No such allowance may be made in respect of automobiles or other vehicles used solely for pleasure, a building used by the taxpayer solely as his residence, or in respect of furniture or furnishings therein, personal effects, or clothing; but properties and costumes used exclusively in a business, such as a theatrical business, may be the subject of a depreciation allowance.

* * * * *

SEC. 29.23(1)-4. *Capital Sum Recoverable Through Depreciation Allowances.*—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. (See sections 113(a) and 114.) To this amount should be added from time to time the cost of improvements, additions, and betterments, and from it should be deducted from time to time the amount of any definite loss or damage sustained by the property, through casualty, as distinguished from the gradual exhaustion of its utility which is the basis of the depreciation allowance. (See section 113(b).) * * *

SEC. 29.23(1)-5. *Method of Computing Depreciation Allowance.*—The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other

recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. Therefore, taxpayers must furnish full and complete information with respect to the cost or other basis of the assets in respect of which depreciation is claimed, their age, condition, and remaining useful life, the portion of their cost or other basis which has been recovered through depreciation allowances for prior taxable years, and such other information as the Commissioner may require in substantiation of the deduction claimed.

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. * * *

APPENDIX B

Internal Revenue Code of 1954:

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

- (1) of property used in the trade or business, or
- (2) of property held for the production of income.

(b) *Use of Certain Methods and Rates.*—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

- (1) the straight line method,
- (2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),
- (3) the sum of the years-digits method, and
- (4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

(c) *Limitations on Use of Certain Methods and Rates.*—Paragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—

(f) *Basis for Depreciation.*—The basis on which exhaustion, wear and tear and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

(26 U.S.C. 1958 ed., Sec. 167 (a), (b), (c) and (f).)

SEC. 7805. RULES AND REGULATIONS.

(a) *Authorization.*—Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of Regulations or Rulings.*—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U.S.C. 1958 ed., Sec. 7805 (a) and (b).)

Treasury Regulations on Income Taxes (1954 Code):

SEC. 1.167(a)-1. *Depreciation in general.*—

(a) *Reasonable allowance.* Section 167(a)

provides that a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held by the taxpayer for the production of income shall be allowed as a depreciation deduction. The allowance is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), so that the aggregate of the amounts set aside, plus the salvage value, will, at the end of the estimated useful life of the depreciable property, equal the cost or other basis of the property as provided in section 167(f) and § 1467(f)-1. An asset shall not be depreciated below a reasonable salvage value under any method of computing depreciation. See paragraph (c) of this section for definition of salvage. The allowance shall not reflect amounts representing a mere reduction in market value.

(b) *Useful life.* For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experi-

ence is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year and shall be redetermined when necessary regardless of the method of computing depreciation. However, estimated remaining useful life shall be redetermined only when the change in the useful life is significant and there is a clear and convincing basis for the redetermination. For rules covering agreements with respect to useful life, see section 167(d) and § 1.167(d)-1.

(c) *Salvage*. Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b) of this section, salvage value may be redetermined based upon facts known at the time of such redetermination of useful life. Salvage, when reduced by the cost of removal, is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value.

Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation, or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See, however, § 1.167(b)-2(a) for the treatment of salvage under the declining balance method. The taxpayer may use either salvage or net salvage in determining depreciation allowances but such practice must be consistently followed and the treatment of the costs of removal must be consistent with the practice adopted. For specific treatment of salvage value see §§ 1.167(b)-1, 1.167(b)-2, and 1.167(b)-3. When an asset is retired or disposed of, appropriate adjustments shall be made in the asset and depreciation reserve accounts. For example: The amount of the salvage adjusted for the costs of removal may be credited to the depreciation reserve.

* * * * *

SEC. 1.167(b)-0. *Methods of computing depreciation.*—

(a) *In general.* Any reasonable and consistently applied method of computing depreciation may be used or continued in use under section 167. Regardless of the method used in computing depreciation, deductions for depreciation shall not exceed such amounts as may be necessary to recover the unrecovered cost or other basis less salvage during the remaining useful life of the property. * * *

* * * * *

SEC. 1.167(b)-1. *Straight line method.*—

(a) *Application of method.* Under the straight line method the cost or other basis of the property less its estimated salvage value is deductible in equal annual amounts over the period of the estimated useful life of the property. The allowance for depreciation for the

taxable year is determined by dividing the adjusted basis of the property at the beginning of the taxable year, less salvage value, by the remaining useful life of the property at such time. For convenience, the allowance so determined may be reduced to a percentage or fraction. The straight line method may be used in determining a reasonable allowance for depreciation for any property which is subject to depreciation under section 167, and it shall be used in all cases where the taxpayer has not adopted a different acceptable method with respect to such property.

* * * * *

Treasury Regulations 103, promulgated January 29, 1940, under the Internal Revenue Code of 1939:

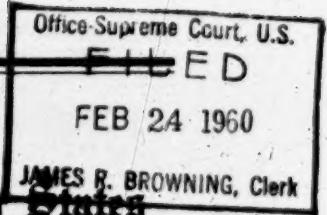
SEC. 19.23(1)-1. *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business may be deducted from gross income. For convenience such an allowance will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence. The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will, at the end of the useful life of the property in the business, equal the cost or other basis of the property determined in accordance with section 113. * * *

BRIEF FOR

THE

RESPONDENTS

LIBRARY
SUPREME COURT, U. S.



**In the
Supreme Court of the United States**

OCTOBER TERM, 1959

No. 143

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,
v.
ROBLEY H. EVANS AND JULIA M. EVANS,
Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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BRIEF FOR THE RESPONDENTS

STATUTES AND REGULATIONS INVOLVED

For the purpose of enabling the Court to compare the key portions of the depreciation regulations applicable to the years involved (Regulations 111, portions of which are reprinted in the Commissioner's opening brief, Appendix A, pages 37-38) with the analogous portions of the depreciation regulations issued in 1956, we have set forth

Reg. Sec. 1.167(a)-1(b) and 1.167(a)-1(c)—containing the Commissioner's current definitions of "useful life" and "salvage value"—at Appendix A, *infra*, pages 89-91.

QUESTION PRESENTED

During 1950 and 1951, Robley H. Evans (herein called the "taxpayer") was in the business of leasing automobiles to a corporation which in turn leased and rented them to the general public. The questions presented concern the computation of the depreciation allowances for the taxpayer's automobiles under Section 23 (1) of the 1939 Internal Revenue Code for the taxable years 1950 and 1951. Specifically, they are:

(1) Whether the "useful life" of the taxpayer's automobiles is (a) the physical or inherent functional life of such automobiles (i.e., their life for general business purposes); a four-year life, as contended by the taxpayer, or (b) an average, or other imputed, period during which such automobiles happen to be held by the taxpayer, as contended by the Commissioner.

(2) Whether the "salvage value" of such automobiles is (a) the residual, junk or scrap value left in such automobiles at the end of their physical or inherent functional lives, as contended by the taxpayer, or (b) the estimated proceeds from the disposition of such automobiles which may be realized by the taxpayer based upon an assumed market value and an assumed disposition of such automobiles after an estimated period of use by the taxpayer, as contended by the Commissioner.

STATEMENT**(1) Petitioner's business.**

During the years 1950 and 1951, the taxpayer was engaged in the business of leasing automobiles to Evans U-Drive, Inc. at a monthly rental of \$45 per automobile. U-Drive was managed by the taxpayer, and was engaged, in Seattle, Washington, in the business of leasing and renting automobiles to the public. "Renting" refers to the hiring out of vehicles for relatively short periods, *e.g.*, by the hour or week; "leasing" refers to the hiring out of vehicles for relatively long periods, *e.g.*, for 18 to 36 months (R. 63, 64). Some of U-Drive's automobiles were leased for extended periods and the rest were rented for relatively short terms, ranging from a few hours to several weeks (R. 45, 63, 64).

Under the terms of the lease agreement between the taxpayer and U-Drive, the taxpayer was obligated to furnish U-Drive with a sufficient number of automobiles to enable it to operate and conduct its leasing and renting business efficiently. Automobiles which, from time to time, became surplus to U-Drive were returned to the taxpayer, who disposed of them at wholesale prices to used car dealers (R. 46, 48, 49).

Automobiles to be leased by U-Drive to others for extended periods of time were purchased by the taxpayer as required. At the termination or cancellation of such leases, the automobiles were returned to the taxpayer, who sold them (R. 64). When sold, such transient rental automobiles had been driven from 15,000 to 20,000 miles, whereas long-term lease vehicles had been driven as much as

50,000 miles (R. 54). The automobiles were generally in good physical condition and state of repair at the time of sale (R. 54, 58), and the taxpayer and U-Drive could have continued to use them longer than they did (R. 80-83).

The taxpayer periodically owned more automobiles than were necessary for the efficient operation of the short-term rental business of U-Drive. When this situation occurred, he would examine the cars in use and sell the number which were not needed. The oldest and least desirable automobiles were sold first (R. 51).

(2) Factors affecting purchase and sale of automobiles by taxpayer.

There was no way to predict what an automobile would bring some 18, 24 or 36 months in the future, when the lease to the customers of U-Drive terminated and the automobile might be disposed of (R. 65). It was impossible for the taxpayer to project what the sales price of an automobile was going to be when he bought it, because he never knew when he was going to dispose of it, and could not foresee 18, 12 or even 6 months ahead, the effects of the numerous economic and other factors affecting used automobile values (R. 71).

Among these factors were strike conditions, manufacturing conditions, the introduction of mechanical innovations, the advent of war and the anticipation of rationing (R. 66, 69, 71).

During the years 1950 and 1951, the taxpayer disposed of certain automobiles used in his business at the respective times and for the respective prices set forth in the Com-

missioner's Exhibits B and C (R. 129-135), the taxpayer having purchased these automobiles at the respective dates and for the respective prices set forth in said Exhibits.

(3) Accounting practice as to "useful life" and "salvage value."

Certified public accountants—partners, respectively, in the firms of Ernst & Ernst and Price Waterhouse & Co.—testified that "useful life" has consistently meant and still means for both accounting and federal income tax purposes, not the period of use of an asset in the hands of the taxpayer, but the economic life, the general business life, of the asset in whatever hands (R. 83-91). (The uncontradicted testimony at the trial in the Tax Court was that such economic life is four years [R. 70].) The accountants testified that "salvage value" has meant for tax and accounting depreciation purposes the scrap or junk value remaining in the asset when its usefulness has been exhausted after such general business life, and not the resale value of the asset upon its sale by a particular taxpayer for use by somebody else (R. 85, 87, 89).

(4) The taxes here involved.

During the years in issue, the taxpayer depreciated his automobiles at the rate of 25% per annum without any allowance for salvage value. This rate represented a four-year useful life, and resulted in deductions in the amounts of \$77,972.71 and \$92,890.05 for the years 1950 and 1951, respectively (R. 22). Such amounts were deducted pursuant to the provisions of Section 23(1) of the 1939 Code, applicable to the years in issue.

On March 9, 1955, the Commissioner sent the taxpayer a statutory notice of deficiency, alleging, among other things, that the taxpayer had overstated the 1950 and 1951 depreciation deductions allowable with respect to his automobiles. In that notice, the Commissioner recomputed depreciation for the years 1950 and 1951 in the respective amounts of \$21,858.62 and \$30,374.13, stating that the average useful life of automobiles in the taxpayer's business was not in excess of seventeen months and the average salvage value of said automobiles was not less than \$1,325.00 or the adjusted basis of said automobiles as of January 1, 1950, whichever amount was the lesser (R. 12).

In computing the rate of depreciation for his automobiles, the taxpayer used their physical or inherent functional life (i.e., their life for general business purposes)—four years. In the notice of deficiency, the Commissioner claimed that the "useful life" of the taxpayer's automobiles should be determined not on the basis of their physical or inherent functional life but rather on the basis of the average period during which the taxpayer held them (R. 12). The Commissioner also claimed that the salvage value of such automobiles should be determined for the years in issue by taking the average of the amounts realized by the taxpayer from the disposition of his automobiles during those years (R. 12).

(5) The proceedings below.

The taxpayer petitioned the Tax Court for a redetermination of the proposed deficiency, and trial was held in Seattle on February 5, 1957. On July 31, 1957, the

Tax Court filed a memorandum opinion (R. 24-33) holding that the taxpayer's automobiles used under extended term leases had a useful life of three years and a salvage value of \$600, and that the taxpayer's automobiles used in short-term rentals had a useful life of 15 months and a salvage value of \$1,375. With respect to the salvage value issue, the Tax Court further held that if the "undepreciated cost" (apparently meaning adjusted basis) of the automobiles in service at January 1, 1950, was less than \$600 and \$1,375 for the respective classes of automobiles, those amounts should be the salvage value of those automobiles. The Tax Court apparently adopted, without discussion, the Commissioner's definitions of useful life and salvage value. Pursuant to the Tax Court's opinion, a decision was entered under Rule 50 of the Rules of the Tax Court on February 7, 1958 (R. 34), adjudging a total deficiency of \$26,239.64 for the years 1950 and 1951, of which \$23,139.12 is attributable to the issue here involved—the taxpayer's deductions for automobile depreciation. (The balance of the deficiency, already paid, was attributable to issues settled by stipulation.)

d

On appeal, the Court of Appeals for the Ninth Circuit reversed and remanded, holding that the Tax Court had applied erroneous definitions of "useful life" and "salvage value"; that "useful life" meant the entire period of economic usefulness of the asset, not the period of use in a particular taxpayer's business; and that "salvage value" accordingly meant the value remaining in the asset at the end of "useful life" so defined, not the proceeds realized from the sale or other disposition of the asset when it was no longer useful in the business of the particular taxpayer (R. 115).

SUMMARY OF ARGUMENT

The useful life of an asset determines the annual rate of depreciation. (Thus, an asset with a four-year useful life is depreciated at the annual rate of 25% of the depreciable amount.) It follows that precise definition of the term "useful life" is fundamental to a determination of depreciation.

But that term was neither used in, nor defined by, the 1939 Code (applicable to the years here in issue) or any of the prior revenue acts. Likewise, the Commissioner's regulations from 1918 to 1956 fail to provide a definition.

Accordingly, we must look elsewhere to determine the meaning of "useful life". From the first of the federal income tax statutes, the useful life of property, for depreciation purposes—as clearly appears from the judicial decisions, the Treasury's administrative practices and pronouncements, and the practices of the business community as evidenced by expert accounting testimony—has meant the physical or inherent functional life of the property (i.e., the property's life for general business purposes), and not the period during which it is estimated it will be held by a particular taxpayer in his business.

This was the opinion of the Ninth Circuit below.

The authorities hereinafter discussed fully support taxpayer's use of a four-year life for depreciating automobiles used in business. Instead, the Commissioner has urged the adoption of his new definition of "useful life" as the taxpayer's holding period. However, he has failed to cite a single relevant authority in support of that definition. In the absence of such authority, he appears to be attempting to apply his new regulations (promulgated in June, 1956, under the 1954 Code) to this case, involving the taxable years 1950 and 1951 (264 F. 2d 506; R. 106).

Salvage value is the reciprocal of useful life. The salvage value of an asset under any definition of useful life is a residual value—the asset's value upon the completion of the depreciation process. Thus "salvage value", for depreciation purposes, means the residual, junk or scrap value of property remaining at the end of its full "useful life"—its inherent functional life for business purposes. It is not the estimated market value which may be realized at the unpredictable time when a given taxpayer may decide to sell or otherwise dispose of the property before the end of its useful life. The courts and the Commissioner himself have consistently negated market value as a factor in determining salvage value, rejecting market value as an element in determining depreciation rates or amounts.

What the Commissioner is trying to do here is to trim the depreciation deduction at both ends: greatly to reduce the actual depreciable life of an automobile and, by calling the resale value of the automobiles their salvage value, greatly to reduce the amount which can be deducted.

The Commissioner's true objective here, in defiance of Congressional purposes, is to prevent taxpayers from availing themselves of capital gains on sale of business assets under Section 117(j) of the 1939 Code (now Section 1231 of the 1954 Code), in force since 1942. Having failed in other, more direct, attempts to accomplish this end, the Commissioner has apparently decided on another approach, exemplified by this case. This approach requires him to upset the long-accepted definitions of "useful life" and "salvage value".

As belatedly admitted by the Treasury's letter of February 12, 1960 (Appendix B, *infra*), the policy changes which the Commissioner wants must be made by legislation.

ARGUMENT.

I.

THE USEFUL LIFE OF AN ASSET FOR FEDERAL INCOME TAX DEPRECIATION PURPOSES HAS ALWAYS BEEN DEFINED AS THE PHYSICAL OR INHERENT FUNCTIONAL LIFE OF THE ASSET (i.e., ITS LIFE FOR GENERAL BUSINESS PURPOSES), AND NOT A SHORTER PERIOD DURING WHICH A PARTICULAR TAXPAYER MAY HAPPEN TO HOLD SUCH ASSET.

The issues in the case at bar—indeed, in our view, the fact that there is a case at all—hinge upon this fundamental point in the federal income tax law: As a taxpayer deducts each dollar of the statutory depreciation allowance for “exhaustion, wear and tear” of a depreciable business property (Section 23(1) of the 1939 Code), the basis for determining gain or loss on the sale of such property is reduced by the same dollar (Section 113[b][1][B] of the 1939 Code). If the taxpayer then happens to sell the property, after more than six months, in a market favorable enough to give him a price greater than the property’s cost basis *so reduced by depreciation*, the differential is taxable, but at the capital gains maximum rate of 25% instead of the applicable (and higher) ordinary rate. That is the result prescribed by Section 117(j) of the 1939 Code (Section 1231 of the 1954 Code), in force since 1942.

As we shall show, the present proceeding is the most recent in a series of attempts by the Treasury to overcome

or minimize the beneficial rate granted by Section 117(j). And we think it important to emphasize at the outset the following:

(1) The Commissioner's deficiency notice to Mr. and Mrs. Evans asserted not only the conceptions of useful life and salvage now in issue before the Court, but also made the following claim:

"It is further held that you were also in the business of selling used automobiles during the years 1950 and 1951. Consequently, the profit realized from the sale of the automobiles was income from the sale of property held primarily for sale in the ordinary course of your business within the meaning of section 117(j) of the Internal Revenue Code and such income may not be treated as a capital gain under the above-mentioned section of the Code" (R. 12).

After trial, the Commissioner conceded the error of that contention, saying:

"Respondent [Commissioner] concedes the issue of whether the automobiles sold in 1950 and 1951 were held for sale to customers in the ordinary course of business, and agrees that such sales may be treated as sales of property used in the taxpayers' trade or business within the meaning of section 117(j) of the Internal Revenue Code of 1939" (Page 1, Brief for the Respondent in the Tax Court, Docket No. 58067).

(2) Government counsel admitted at the trial that the Government's position

is somewhat in the alternative because we have adjusted the useful life and we have ad-

justed the depreciation and *in taking that action* we have cut down the amount of gain or profit considerably" (R. 40, emphasis added).

(3) All that remained was for the Commissioner to say, as he now has, "The question in this case bears upon the proper computation or determination of capital gain" (Brief for the Petitioner, page 11).

In the light of what we believe to be the Commissioner's true motive in raising the depreciation issues in this case—to attempt once more to limit the capital gains treatment under Section 117(j) of the 1939 Code—we shall demonstrate that the term useful life means and has been understood to mean the physical or inherent functional life of the asset. A fuller discussion of the Commissioner's attitude toward Section 117(j) of the 1939 Code and his previous attempts to limit its application may be found beginning page 71, *infra*.

The present dispute¹ arises in spite of judicial interpretation, administrative practices and pronouncements under the 1939 Code and prior revenue acts and accounting practices (confirmed by expert opinion), all of which confirm that for purposes of the depreciation deduction "useful life" means the period during which an asset is physically

¹ The current depreciation litigation—involving several cases dealing with useful life and salvage value—seems clearly to have been inspired by the Commissioner's resistance to the allowance of capital gains on the sale of property depreciated under the new methods permitted by Congress in Section 167 of the 1954 Internal Revenue Code. See *The Hertz Corporation v. United States*, 268 F. 2d 604 (3rd Cir., 1959), No. 283, this Term, certiorari granted October 12, 1959.

useful for business purposes, rather than the shorter period during which it happens to be owned by a particular taxpayer.

As we shall show, until promulgation of the 1956 depreciation regulations, the definition of "useful life" which was "part and parcel of the actual and effective administration of the . . . tax statute"² was: the life of the asset during which it still has usefulness, and not just the period during which it is held by a given taxpayer until, for reasons perhaps completely unconnected with the newness, oldness or *usefulness* of the asset, it is sold or otherwise disposed of.

Under the Commissioner's new view of useful life, contradictory and confusing results would ensue. For example, let us consider the case of two taxpayers who are in the same type of business and who buy—at the same time and at the same price—an identical asset. (Let us assume also the same degree of physical usage and wear and tear, and the same inspection and repair procedures.) Suppose that the two taxpayers accurately estimate their holding periods differently—all else being the same.

Under the Commissioner's definition of useful life in this case, depreciation will be computed differently for the two taxpayers in the above example, despite the fact that the assets involved will be undergoing exactly the same rate of "exhaustion, wear and tear" contemplated by the statute. Thus, the underlying statutory definition

² *Jackson Finance and Thrift Co. v. Commissioner of Internal Revenue*, 260 F. 2d 578, 581 (10th Cir., 1958).

of depreciation would be changed from "exhaustion, wear and tear" to something indeterminate—some combination of exhaustion, wear and tear and other considerations foreign to and unconnected with the wearing out of the assets and the direction of the statute.

The following table traces briefly the basic depreciation provision of the 1939 Code and prior revenue acts, and shows the stability of this provision over a period of 41 years—from 1913 to 1954:

Depreciation Provision**Statute**

"A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business".

Subdivision B, sixth, Revenue Act of 1913 (38 Stat. 114 [1913])

"A reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade".

Section 5(a) seventh, Revenue Act of 1916 (39 Stat. 756 [1916]); and

Section 5(a) seventh, Revenue Act of 1917 (39 Stat. 756 [1916]), as amended by Act of October 3, 1917 (40 Stat. 300 [1917]).

"A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business including a reasonable allowance for obsolescence"

Section 214(a)(8), Revenue Acts of:—1918 (40 Stat. 1057 [1919]),—1921 (42 Stat. 227 [1921]),—1924 (43 Stat. 253 [1924]).

Sections 214(a)(8) and 234(a)(7) of Revenue Act of 1926 (44 Stat. 9 [1926]).

Section 23(k), Revenue Acts of:

—1928 (45 Stat. 791 [1928]),—1932 (47 Stat. 169 [1932]).

Section 23(l), Revenue Acts of:

—1934 (48 Stat. 680 [1934]),—1936 (49 Stat. 1648 [1936]),—1938 (52 Stat. 447 [1938]).

Internal Revenue Code of 1939 (53 Stat. 1 [1939]).

"A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

Section 23(l), Internal Revenue Code of 1939, as amended by the Revenue Act of 1942 (56 Stat. 798 [1942]), and as in force up to the effective date of Section 167 of the 1954 Internal Revenue Code.

(1) of property used in the trade or business, or
(2) of property held for the production of income."

These statutory provisions do not mention "useful life", let alone define it.

Running parallel with this constant statutory provision were basic regulations on depreciation which also remained virtually unchanged in all respects material to the present case, from 1918 to the date on which the Commissioner issued his new 1956 regulations. Those regulations are important because they mention "useful life". A succinct description of all of the relevant depreciation regulations which had been in force before Congress addressed itself to the 1954 Code appears in the Ninth Circuit's opinion below (264 F. 2d at 507, 508; R. 108, 109):

"The first appearance of the [term] 'useful life' . . . in Treasury Regulations was in Treasury Regulations 45, Article 161 (1919), effective for the calendar years 1918-19 and 1920. Article 161 provided in part, as follows: 'The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a consistent plan by which the aggregate of such amounts for the *useful life of the property in the business* will suffice, with the salvage value, at the end of such useful life to provide in place of the property its cost . . . ' (Emphasis added)

"Article 165 of the same Regulations provided in part, as follows: 'The capital sum to be replaced *should be charged off over the useful life of the property* . . . ' (Emphasis added)

"Similar wording with changes not material to the problem before us appeared in subsequent Treasury Regulations through Regulations 103, Section 12.23

(1)-1-5, effective for the tax years 1939-40 and 1941. The words 'in the business' which appeared in Article 161 of Regulations 45 continued to appear in successive regulations until the issuance of Regulations 111 in 1942. No definition or further explanation of the [term] 'useful life' . . . appeared in any of the regulations to which reference has been made until the issuance of Treasury Regulations T.D. 6182, promulgated under the 1954 Revenue Code. The [term] 'useful life' . . . [is] not defined or explained in Regulations 111. The language of the Regulations does not limit 'useful life' to the useful life of the depreciable assets in the business of the taxpayer or to the period during which such assets are held by the taxpayer."

Thus, neither the basic depreciation statutes nor the Commissioner's regulations defined the term useful life. In the absence of such statutory or regulatory definition, we now turn to the customary precedents—the cases, the Commissioner's pronouncements and the practice in the accounting profession over a period of many years (as evidenced by expert opinion). The precedents established, in the opinion of the Ninth Circuit below, that for purposes of depreciation deductions "useful life" means the physical or inherent functional life of the property, and not the intended or actual period of the taxpayer's use of the property.

As the Court will observe in the authorities discussed below, a striking feature of the legal history of that phrase over the years is the vigor with which the Commissioner himself pressed the definition for which the taxpayer here contends.

1. *The prior cases.*

The principle that "useful life" means the business life of the asset itself, and not the period such asset is held by a specific taxpayer, has long been recognized by the courts.

In *Sanford Cotton Mills*, 14 B.T.A. 1210 (1929), Acq. X-2 CB 63, the taxpayer, a manufacturer of cotton sheeting, contested the Commissioner's reduction of the rate of depreciation of motor trucks from 33- $\frac{1}{3}$ % (three-year life) to 20% (five-year life). The taxpayer made a practice of keeping the trucks approximately 2 $\frac{1}{2}$ years. The Board of Tax Appeals nevertheless held that a rate of 25% (four-year life) was reasonable.

In *Merkle Broom Co.*, 3 B.T.A. 1084 (1926), Acq. V-2 CB 2, which concerned the proper depreciation rate for the taxpayer's fleet of automobiles used by its salesmen, the taxpayer claimed 33- $\frac{1}{3}$ % per annum (three-year life) and the Commissioner allowed 20% per annum (five-year life). Although the Board of Tax Appeals found that the taxpayer renewed its fleet every second year, it nevertheless held that the proper rate for depreciation was 25% (four-year life).

In *Max Kurtz, et al.*, 8 B.T.A. 679 (1927), Acq. VII-1 CB 18, the taxpayer contested the Commissioner's determination of a five-year useful life for business automobiles and trucks which the Board of Tax Appeals found were traded in by the taxpayer after two or three years of use. Yet the Board held:

"The Board is of the opinion that, upon consideration of all the evidence, the Commissioner's allowance for exhaustion, wear and tear of automobiles at the rate of 20 per cent per annum was reasonable." (8 B.T.A. at 683.)

The Commissioner officially acquiesced in these decisions.

In *General Securities Co.*, B.T.A. Memo, CCH Dec. 12,500-D (1942), *aff'd per curiam* on another issue, 137 F. 2d 201 (6th Cir. 1943), the facts with respect to the depreciation issue were found by the Board of Tax Appeals as follows:

"In its business petitioner used one or two automobiles in which its agents traveled over territory located in all of the southern states. Each automobile traveled some 60,000 to 75,000 miles a year. *Petitioner kept his automobiles from one to two years.* When petitioner traded its cars in after one year, from a value standpoint, they had a third to a half of their original value left. *The normal useful life of automobiles used by petitioner in its business was three years.*" (B.T.A. Memo, CCH Dec. 12,500-D at 37,941; emphasis added.)

Again, the Commissioner in that case was contending for a longer useful life for petitioner's automobiles than the three years used by petitioner in computing its depreciation. Neither the parties nor the Board of Tax Appeals considered it proper to equate the automobiles' useful life with the taxpayer's one- or two-year period of ownership.

In each of the foregoing cases the Commissioner took the position that the useful life of the automobiles was a

period substantially longer than the taxpayer's customary holding period.

As early as 1916, the court in *Cohen v. Lowe, Collector*, 234 Fed. 474, 476 (D.C.S.D. N.Y., 1916), stated:

"[The depreciation allowance] is to be based upon the life of the building, in the sense of the number of years the building would remain in a condition to be habitable for the uses for which it was constructed and used. . . ."

Other cases which similarly illustrate the traditional distinction between an asset's useful life and the periods during which it happens to be used by a particular taxpayer in his business are: *West Virginia & Pennsylvania Coal & Coke Co.*, 1 B.T.A. 790, 792 (1925); *J. R. James*, 2 B.T.A. 1071, 1072 (1925), Acq. V-1 CB 3; *Wallace G. Kay*, 10 B.T.A. 534, 535 (1928), Acq. VII-1 CB 17; *W. N. Foster, et al.*, 2 TCM 595, 597 (1943); *John A. Maguire Estate, Ltd.*, 17 B.T.A. 394, 399 (1929), Acq. IX-1 CB 34; *Nat Lewis*, 13 TCM 1167, 1170 (1954); and *Whitman-Douglas Co.*, 8 B.T.A. 694, 697 (1927).

The Commissioner argues (Brief for the Petitioner, page 26, footnote 15) that in the cases discussed above the issue was not squarely presented nor was any theory of useful life presented. The Commissioner is mistaken. The proper meaning of useful life was fundamental to the decision in each of those cases, since the question in each case was the proper depreciation deduction. For this purpose it was necessary to know the useful life, and this was

determined in terms of how long the asset would last.³ Furthermore, the Ninth Circuit in its opinion below found that the issue was squarely presented, saying:

"Further evidence of the position of the Commissioner is drawn from his acquiescence in decisions of the Board of Tax Appeals which measured 'useful life' of the depreciable asset not by the holding period of such asset by the particular taxpayer, but by the economic or physical life of such asset." (264 F. 2d at 509; B. 110.)

Having demonstrated that the cases in which a determination of the depreciation deduction was in issue required a determination of the useful life of the assets depreciated, and that useful life was invariably defined to mean physical or inherent functional life, we shall now consider the cases which the Commissioner suggests have reached a different result.

The Commissioner has attempted to wrest, from certain dicta of this Court, support for his new definition of useful life (Brief for the Petitioner, pages 15-16, 19-22). This

³ This is borne out by an examination of the underlying briefs and records. For example, in *Max Kurtz, et al.*, 8 B.T.A. 679 (1927), Acq. VII-1 CB 18, the transcript of testimony (pages 41-43) shows questioning directed to finding out "How long [the] equipment would last under [given] conditions"; in *Sanford Cotton Mills*, 14 B.T.A. 1210 (1929), Acq. X-2 CB 63, the petitioner's brief (pages 6-7) squarely posed the question of how long the automobiles would "last".

It should also be noted that in a number of the cases cited above, the Commissioner has officially acquiesced in decisions which defined useful life for depreciation purposes as meaning the business life of the asset irrespective of the taxpayer's holding period.

attempt centers around *United States v. Ludey*, 274 U.S. 295 (1927),⁴ and certain language which appeared in the Treasury's depreciation regulations from 1918 to 1942, but which did not appear there during the years in issue—1950 and 1951. We believe that attempt is completely inconclusive, for the following reasons:

(a) The Commissioner basically relies on the following single sentence in *Ludey* (274 U.S. at 300-301):

"The amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with the salvage value) suffice to provide an amount equal to the original cost."

That statement was unnecessary in the determination of the case. All that *Ludey* decided was that the deductions for depreciation and depletion (the amounts of which were uncontroverted) to which the taxpayer was entitled should be subtracted from original cost in determining the basis of certain oil properties at the time of sale. There was no dispute as to the method of depreciation or depletion (274 U.S. at 297). Furthermore, a number of the cases cited above were decided after the 1927 decision in *Ludey*, and, indeed, the Commissioner acquiesced in a number of them.

⁴ The only other decision of this Court on which the Commissioner places any emphasis (Brief for the Petitioner, page 16) is *Detroit Edison Co. v. Commissioner of Internal Revenue*, 319 U.S. 98 (1943). An examination of the opinion, record and briefs in that case fails to disclose anything which appears to be helpful in the disposition of the issues at bar.

(b) The phrase "useful life of the property in the business" (which appeared in the depreciation regulations from 1918 to 1942) did not appear in the regulations applicable to the taxable years in question, which, instead, referred to "useful life of the depreciable property" (Regulations 111, Sec. 29.23(1)-1). The term "in the business" as it appeared in the regulations from 1918 to 1942, had the sole purpose of defining the nature or type of assets which could be depreciated by a taxpayer, that is, property devoted to business, or, simply, business property. It is clear that the term did not mean and never was intended to be a limitation on the period during which business assets could be depreciated.

The Ninth Circuit below properly assessed the language change in the regulations when it stated (264 F. 2d at 508; R. 109):

"The significance, if any, to be attached to the omission of the words 'in the business' from Regulations 111 is obscure. We attach no significance thereto because in our view the practice and position of the Commissioner has been the same under Regulations 45 and succeeding regulations up to T.D. 6182 [the depreciation regulations issued in June, 1956], except for a few recent cases under Regulations 111 of the Internal Revenue Code of 1939, in which the Commissioner asserted the concepts of 'useful life' and 'salvage value' embodied in T.D. 6182.

"From the practice of the Commissioner over the years, it appears to us that the phrase 'in the business' included in earlier regulations simply

defined the type of assets which were subject to the depreciation allowance. The omission of such phrase from Treasury Regulations 111 would not furnish the basis for an interpretation of the term 'useful life' which it did not have when the phrase appeared in the regulations."

(c) The Commissioner argues (Brief for the Petitioner, page 22, footnote 14): "In view of the fact that a specific detailed definition of depreciable property was contained in Section 19.23(1)-2 [of Regulations 103, effective for 1939-41], the use of the words 'in the business' in Section 19.23(1)-1 undoubtedly was intended to have a function other than that of mere definition. And this function, we submit, was to limit the concept of 'useful life' to that time during which the property was useful 'in the business' of the taxpayer."

The Commissioner's inference appears totally unjustified, however, when it is realized that Regulations 111, applicable to the years in issue, contain the following provision:

"The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business, or treated under section 29.23 (a), 15 as held by the taxpayer for the production of income." (Reg. 111, Sec. 29.23(1)-2, in part.)

The entire portion of this sentence beginning with "or treated" was added by T.D. 5196, 1942-2 CB 96, 100, after Section 121(c) of the Revenue Act of 1942 (56 Stat. 798, 819) added "property held for the production

of income" to the items on which depreciation could be deducted. Thus, "used in the . . . business" and "held . . . for the production of income" were simply parallel definitions of the two basic types of assets depreciable after the 1942 statutory amendment. "Useful life of the property in the business" in the pre-1942 regulations (and in *Ludey*) was the generic phrase used to describe the kind of property which could be depreciated, just as "useful life of the depreciable property" in the 1942-and-following regulations merely enlarged the generic class of such property, as required by the 1942 change in the statute.

Accordingly, "in the business" did not have the function of limiting the definition of useful life to a taxpayer's period of use, as lately claimed by the Commissioner.

The Commissioner's claim that his present view of useful life has always been the law makes his citation of the other cases listed at page 16 of the Brief for the Petitioner somewhat puzzling. For if those cases—which are so clearly far afield—represent the best authorities for his position which he has been able to find, his conclusion that his position "accords with the authorities" (brief, page 9) would seem to be without foundation.

A review of the Commissioner's "authorities" discloses the following:

Gambrinus Brewery Co. v. Anderson, 282 U.S. 638 (1931), merely allowed an obsolescence deduction to a brewery owner, for the taxable years 1918 and 1919, for

buildings which were specially constructed for brewery purposes, were not commercially adaptable for any other use and thus were rendered valueless by the onset of national prohibition. These points are irrelevant here.

Virginian Hotel Corp. v. Helvering, 319 U.S. 523 (1943), held that the basis of depreciable property is reduced by the amount "allowable" each year, whether or not claimed by the taxpayer. The point is not at issue here, and certainly is not disputed by the taxpayer.

Cohn v. United States, 259 F. 2d 371 (6th Cir. 1958) is discussed at pages 28, 42-43 and 62-63 herein.

Becker v. Anheuser-Busch, Inc., 120 F. 2d 403 (8th Cir. 1941), certiorari denied 314 U.S. 625 (1941), concerned a special argument on the alleged obsolescence of beverage bottles and cases incident to the onset of national prohibition. These bottles and cases, held the court, would produce a loss for tax purposes only upon final disposition (120 F. 2d at 148). Like *Gambrinus Brewery*, above, this holding is unexceptionable and irrelevant here.

Burlington Gazette Co. v. Commissioner of Internal Revenue, 75 F. 2d 577 (8th Cir. 1935), stands for the proposition that annual depreciation deductions may not aggregate more than the cost of the asset. We do not dispute this.

Cameron v. Commissioner of Internal Revenue, 56 F. 2d 1021 (3rd Cir. 1932), decided that a change in personnel of a partnership did not create a new partnership, new assets or a new depreciation rate on those assets; that the Board of Tax Appeals was justified in its finding of the March 1, 1913 value of certain depreciable assets; and that the taxpayer could not continue claiming deprecia-

tion deductions after the deductions equaled his original cost. None of these points is relevant here.*

It is apparent, therefore, not only that the holdings in *Ludey* and the other cases cited by the Commissioner are of no value in resolving the issues in this case, but also that the language in *Ludey* from which the Commissioner attempts to gain support for his position is irrelevant.

We shall now turn to recent decisions in which the Commissioner took a position wholly inconsistent with his views in the present case—a position which supports that of the taxpayer herein.

2. Recent Decisions

Philber Equipment Corporation v. Commissioner of Internal Revenue, 237 F. 2d 129 (3d Cir. 1956), provides judicial corroboration (as well as the Commissioner's own assertion) of the principle that a taxpayer's holding period of leased vehicles (trucks, trailers and tractors) does not determine their useful life. There, the taxpayer regularly disposed of such vehicles after the end of one-year terms during which they were leased to taxpayer's customers. Thus, the lease period and the taxpayer's holding period were the same. The court stated:

"Taxpayer knew that when equipment was purchased, it would probably be able to rent the equipment for a *period substantially less than its useful life*, and sale of the equipment would follow expiration of a lease." (237 F. 2d at 130; emphasis added.)

And the Commissioner specifically argued to the same effect in his brief, where he stated:

"Because of existing conditions taxpayer knew when it purchased equipment that it would likely be able to rent such equipment only for a *period that was substantially less than its useful life.*" (Brief for Respondent, p. 5, *Philber Equipment Corporation v. Commissioner of Internal Revenue*, (3d Cir.), Docket No. 11,860; emphasis added.)

And again, at page 11 of the Commissioner's brief in that case, he stated:

"... all of the leases involved were only for a one-year term, *a period substantially less than the useful life* of this type of equipment as its resale in the tax years and re-release in later years demonstrates." (Emphasis added.)

Here is a clear recognition by the Commissioner, in 1956, of the accepted meaning of useful life, directly contradicting the Commissioner's position in the case at bar.⁵

Similarly, in *Cohn v. United States*, 259 F. 2d 371 (6th Cir. 1958), cited by the Commissioner in his opening brief in this Court (page 16), the taxpayers bought equipment in 1941 and 1942 for use in Army Air Corps flying schools, estimating that the equipment would no longer be useful in those enterprises after December 31, 1944. (The schools were actually terminated in August and October, 1944.) Nevertheless, the Commissioner asserted deficiencies on the basis of a ten-year life for some assets and a five-year life for others (259 F. 2d at 374-75). That action is certainly in direct conflict with the Commissioner's present view of useful life.

It should also be noted that in *Cohn*, when the taxpayers cited provisions of the 1956 depreciation regulations which they deemed beneficial to them, the Commissioner did not hesitate to say:

"At the outset, it should be noted that these Regulations [the 1956 regulations] are applicable only to years involved under the Internal Revenue Code of 1954 and not to the years involved here, which are covered by the provisions of Treasury Regulations 111." (Brief and Appendices for the Appellee, Docket Nos. 13,360-13,362, page 26.)

We refer the Court also to *Pilot Freight Carriers, Inc.*, 15 TCM 1027 (1956), in which the taxpayer's tractors and trailers were shown to have been held by the taxpayer for average periods of 38 months and 32.6 months, respectively. Nonetheless, the court held that the useful lives of such tractors and trailers, for depreciation purposes, were, respectively, four years (instead of 38 months) and five years (instead of 32.6 months). Despite the holding periods shown, the Commissioner had actually *asserted and was contending for deficiencies* on the basis of *five- and six-year useful lives, respectively*.⁶

In addition, recent decisions of the United States District Court for the Southern District of Florida and the Tax Court confirm in all respects the plaintiff's view of useful life—*Davidson v. Tomlinson*, 165 F. Supp. 455 (D.C. S.D. Fla. 1958), and *Lynch-Davidson Motors, Inc. v. Tomlinson*, 172 F. Supp. 101 (D.C.S.D. Fla. 1958), both on appeal to the Fifth Circuit.

In *Charlie Hillard*, 31 T.C. 961 (1959), also on appeal to the Fifth Circuit, the Tax Court confirms plaintiff's view of the meaning of useful life under the 1939 Code. There, the taxpayer was in the rent a car business. On the issue of depreciation allowable for periods during which taxpayer's automobiles were held for rental purposes, Judge Raum stated:

⁶ The briefs in *Pilot Freight Carriers* (which was decided after promulgation of the 1956 depreciation regulations) show an explicit submission to the Tax Court of the conflicting views of the meaning of useful life. (See Commissioner's brief, Docket No. 53266, pages 29-30.)

"Petitioner, in his returns, originally treated the rental cars as having a normal useful life of 3 years; and the Commissioner's determination, agreed to by petitioner, fixed that period at 4 years. Yet, *it was petitioner's practice to sell the cars after they had been in use for only about a year.* Thus, when he purchased the cars in the first instance it was plainly his intention to use them in the rent-a-car operation for a comparatively minor portion of their useful life and then to sell them." (31 T.C. at 969; emphasis added.)

We note two things about this case: First, despite the fact that taxpayer sold the cars after they had been in use only about a year, not only did the Commissioner fail to contend that their useful life was a year, but he actually *extended* the claimed three-year life to four years (which, we note, is the only useful life for automobiles sustained by the record in the instant case); and, second, the Tax Court noted, as did the Third Circuit in the *Philber* case, that the holding period of the vehicles was only a small part of their useful life.

Thus, in a ~~part~~ of litigated cases from 1916 to 1959 there has been implicit in the Commissioner's position--and very frequently he has been most explicit about it--the proposition that useful life means economic physical life, not just a given taxpayer's period of use. In those cases, the Commissioner has given the word "useful" its actual meaning of "able to be used," "fit to be used," or "capable of use", rather than any strained and unsupported definition such as "retained for use", "held for use", or "still usable but not yet sold or otherwise dis-

posed of." In those cases, he has apparently recognized also that the word "life" is far less consistent with any concept of holding period than it is with viable existence. "Life" is something which ends in death, or disintegration or at least absence of *usefulness*—not something which ends with a transfer to other hands for still further use. "Useful life" means today exactly what it has always meant—except for a 1956 Treasury regulation and the Commissioner's current contentions, which try to engraft a new and inconsistent meaning on a well-understood phrase.

The Fifth Circuit's recent non-unanimous decision in *United States v. Massey Motors, Inc.*, 264 F. 2d 552 (5th Cir. 1959), No. 141, this Term, certiorari granted October 12, 1959, is plainly distinguishable on the facts, and is, moreover, erroneous in its statement of the governing legal principles, for the following reasons:

(i) The plaintiff in that case was a new car dealer who "temporarily assigned" new cars for use as executive cars and rental cars. The court referred to the cars as "bought by him for sale but temporarily assigned for use in the business", pointed out that the executive cars in issue were sold for \$11,272.80, more than their cost and the rental cars in issue for \$525.84 more than their cost, and added that "it is quite doubtful that Congress ever intended that automobiles temporarily used by people in the business of selling automobiles should be subject to depreciation at all". The Fifth Circuit was simply using the depreciation provisions to eliminate what it regarded, on the facts, as a loophole under Section 117(j) of the 1939 Code. But in the case at bar, the taxpayer was not a dealer, did not temporarily assign vehicles to rental duty, and

certainly did not, at the conclusion of the lease or rental cycle, sell them for more than it paid for them.

(ii) The Fifth Circuit expressed disappointment (footnote 1 to its opinion) with the Government's concession that the plaintiff was not a "dealer" within the meaning of Section 117(j), and then proceeded to repair the damage by its depreciation decision.

(iii) The Fifth Circuit refers to a special line of cases involving automobile dealers, including *Johnson-McReynolds Chevrolet Corporation*, 27 T.C. 300 (1956); *W. R. Stephens Co. v. Commissioner of Internal Revenue*, 199 F. 2d 665 (8th Cir. 1952); and *Latimer-Looney Chevrolet, Inc.*, 19 T.C. 120 (1952). The facts in those dealer cases are far removed from those in the instant case, as the Commissioner has himself recognized in Rev. Rul. 54-229, 1954-1 CB 124, discussed below at pages 38-39, to which we direct the Court's special attention, and Rev. Rul. 60-15, I.R.B. 1960-3, 9.

(iv) The Fifth Circuit refers to the Commissioner's defeat on the capital gains issue in some of the automobile dealer cases, and states:

"When he [the Commissioner] lost that argument he then issued new regulations [the 1956 regulations] which do precisely cover this type of property as used here. In doing so he did not intend to and did not—he *could* not—change the law. For us to hold that the new regulations of 1956 had the effect of defining useful life as useful life in the business for the first time would amount to our saying that the Commissioner could by Regulations change the law." (264 F. 2d at 559.)

Not only is the Fifth Circuit's opinion devoid of any real argument or citation to support this conclusion

but the conclusion itself appears to us to reduce to this syllogism:

- a. We cannot uphold regulations which change the law.
- b. We are upholding these regulations.
- c. Therefore, these regulations do not change the law.

3. *The Commissioner's own pronouncements.*

Nowhere in the Commissioner's pronouncements before he issued the 1956 depreciation regulations has he indicated the result for which he now contends. Instead, his pronouncements were entirely consistent with the taxpayer's contention and with what taxpayers generally have assumed is useful life for depreciation purposes, namely, general life for business purposes.

Thus, in O.D. 845, 4 CB 178 (1921) (still in full force and unmodified), the Treasury Department took the position that the term "useful life" means "the period of time over which an asset *may be used* for the purpose for which it was acquired. In the case of a new building, this period starts at the time the building is completed and *capable of being used.*" (Emphasis added.) It should be noted that there are no words of limitation and that this interpretation is in terms of the usability of the asset itself for general business purposes, without consideration of whether the particular taxpayer uses it up himself or sells it before the end of such usability. Not only does "useful life" begin when the building is first "capable of being used," but, likewise, its useful life ends when the building no longer "may be used."

Bulletin "F", revised January, 1942,⁷ is a bulletin issued by the Treasury Department (reprinted in 1959 by the Government Printing Office), reciting on its title page that it contains information and statistical data relating to the determination of deductions for depreciation "... from which taxpayers and their counsel may obtain the best available indication of Bureau practice and the trend and tendency of official opinion in the administration of pertinent provisions of the Internal Revenue Code. . . . "

For many years before the taxable years here under review, the Treasury Department's Bulletin "F" has stated as the first portion of its Introduction:

"The Federal income tax in general is based upon net income of a specified period designated as the taxable year. The production of net income usually involves the use of capital assets which wear out, become exhausted, or are consumed in such use. The wearing out, exhaustion, or consumption usually is

⁷In the official reprint of Bulletin "F" in 1955 (IRS Publication Number 173), which reprinted tables of useful lives exactly as in the January, 1942 revision of Bulletin "F", appeared the statement that taxpayers should understand that "the useful lives shown are not mandatory" and that "taxpayers may determine reasonable periods of useful life for their depreciable property. . . ." but that the periods of estimated useful life used by taxpayers are subject to review by the Internal Revenue Service, and taxpayers should be prepared to substantiate the period so used.

Also in 1955 (IRB 1955-8, 53, 1955 CCH Standard Federal Tax Reporter, Para. 37,118A), Part 1 of the 1942 revision of Bulletin "F" was revoked. But Part 2, including that part which is of primary significance to this case—the tables of useful lives and depreciation rates—was not revoked.

gradual, extending over a period of years. *It is ordinarily called depreciation, and the period over which it extends is the normal useful life of the asset.*" (Emphasis added.)

Bulletin "F" contains estimated useful lives and rates of depreciation. The title page states that the useful lives shown therein "... are set forth solely as a guide or starting point from which correct rates may be determined in the light of the experience of the property under consideration and all other pertinent evidence." In Bulletin "F", the Treasury Department informs taxpayers (page 52) that the estimated useful life of automobiles which are "used by commercial enterprises other than public utility and construction" is five years for passenger automobiles and three years for automobiles used by salesmen. Since plaintiff's automobiles were rented and leased for both purposes, the reasonableness of a four-year useful life is sustained by the Commissioner himself. And, we emphasize, Bulletin "F" makes it clear that although such averages "are not prescribed for use in any particular case", they are a starting point from which correct rates may be determined.

*The special classification in Bulletin "F" (page 29) for automobiles used in the construction industry (light—two years, medium—three years, heavy—five years) is a significant variation from the standard three- and five-year lives for automobiles generally, by reason of the introduction to the table of useful lives in the construction industry, which clearly underlines the physical basis of the useful life concept by stating (page 28):

"Ordinarily, the physical property used by contractors in construction has relatively short lives, due to hard usage and, often, general lack of upkeep during rush jobs."

Thus, if testimony to the contrary had been offered, the *prima facie* showing made in Bulletin "F" might perhaps have been overcome. But the only testimony in the record is wholly consistent with Bulletin "F", i.e., that automobiles used in the car rental or car leasing business have a useful life of four years.

We do not believe it plausible that when the Commissioner listed in Bulletin "F" (page 52): "Trucks: . . . medium—6 years; Heavy—8 years", he meant that a medium truck would be *kept and used by a given taxpayer* for six years, and a heavy truck would be *kept and used by that taxpayer* for eight years. Did he not unquestionably mean that though it would be almost impossible to foretell when a taxpayer might decide, perhaps for reasons wholly unconnected with the condition of the truck, to sell it to a neighbor or trade it in on a new one, it was feasible to say that a medium truck, whether in one taxpayer's or a half dozen taxpayers' hands, has a *life* of approximately six years, whereas a heavy truck has a *life* of approximately eight years?

(We cannot refrain from asking why the Commissioner did not simplify his task by stating, in far more simple terms and in one page instead of a catalog of physical lives, that the useful life of a depreciable asset would be *its period of use by a particular taxpayer* if that indeed were his view.)

From the foregoing it would seem clear that if the situation were reversed and the taxpayer in this case were contending for any period other than one suggested by Bulle-

tin "F"—be it a two-year period or a six-year period—as the useful life of its automobiles, the Commissioner would be insisting that in the absence of some justification, such as testimony from the witness stand, or "informed opinion" (Bulletin "F", page 3), or the presentation of experts in the field—Bulletin "F" must govern. Would the Government not be arguing that the unsupported opinion of the taxpayer could not be permitted to *change* the useful life set forth as a guide in Bulletin "F"?

The taxpayer, however, showed affirmatively (R. 70) that the applicable useful life, in this case four years (the average of the three-year and five-year guides set forth by the Government in its Bulletin "F"), is the normal useful life for automobiles used in business.

The Government's position is made to look even more peculiar by reason of Treasury Decision 4422, XIII-1 CB 58, issued by the Commissioner of Internal Revenue under date of February 28, 1934 and still in effect. That decision specifically provided that "The burden of proof will rest upon taxpayer to sustain the deduction claimed [for depreciation]." If, as is apparent, Treasury Decision 4422 puts the burden squarely upon the taxpayer to justify its claimed period of useful life, and if, in the absence of proof, Bulletin "F" is to govern, how can the Government justify its opposition to the designation of a four-year useful life for automobiles when (a) the taxpayer justifies its claimed period by clear proof, unopposed by the Government by any other testimony and (b) Bulletin "F", designated by the Government as the "guide" of the taxpayer also supports the taxpayer?

With respect to Bulletin "F", the Ninth Circuit below correctly characterized its significance for the case at bar:

"While we recognize that Bulletin 'F' does not have the force of law, we do believe that a fair construction of the pertinent provisions of such Bulletin, aided by the practice of the Commissioner, reasonably indicates that the Commissioner did not consider as a factor in determining depreciation the expected or intended disposal plans of the taxpayer with respect to property used in his trade or business, nor did the Commissioner consider that the useful life of an asset was to be measured by the estimated holding period of such asset by the taxpayer." (264 F. 2d at 510; R. 113; emphasis added.)

Indeed, the Commissioner's new definition of "useful life" is inconsistent with the following rulings, which concerned the availability of capital gain treatment of profit from the sale of rented or leased motor vehicles:

In Rev. Rul. 108, 1953-1 CB 185, the Commissioner referred to the practice of selling automobiles after "leasing them for substantially less than their normal useful life". At the expiration of the lease period, the taxpayers involved sold the automobiles. The Commissioner thus was certainly not referring to a useful life which ends when the taxpayer sells the automobiles.

In Rev. Rul. 54-229, 1954-1 CB 124, again the Commissioner referred to a sale of automobiles after they had been leased for substantially less than their useful life. Again he was referring to a useful life in plaintiff's terms—in standard terms and terms consistent with Congressional enactment and intention.

If the Commissioner's present rationale of useful life and salvage value were correct, why did he not, in those rulings, state that the holding period of those automobiles was their useful life, that the selling price was their salvage value, and that, therefore, there was no capital gain? *Had the Treasury taken its present view of "useful life" and "salvage value" at the time these revenue rulings were under consideration, there would have been no need for the rulings, since the capital gain issue would have been effectively foreclosed.*

It is to be noted that this use by the Commissioner of the term "useful life" occurred—in both instances—in a context in which the question of depreciation on leased cars was expressly considered; and the Commissioner was equating useful life with the total functional life of the automobiles for business purposes despite the practice of the taxpayers involved of disposing of the automobiles well before the end of such functional life.

These rulings, and their interpretation of useful life by the agency charged with the responsibility of administering the Internal Revenue Code, are clearly of persuasive weight under the authorities (*Billings v. Truesdell*, 321 U.S. 542, 552-53 [1944]).

Furthermore, in its opinion below, the Ninth Circuit found clear indication in the foregoing official pronouncements of the Commissioner that the meaning of the term "useful life" was physical or inherent functional life of depreciable assets, saying:

"Our attention has been directed to certain pronouncements of the Commissioner dealing with the

general subject under review. In each of such pronouncements, it is evident that the Commissioner's concept of the term 'useful life' was not measured by the period in which the depreciable asset was useful in the taxpayer's business, but was measured rather by the economic or physical life of the depreciable asset." (264 F. 2d at 509; R. 110.)

In a number of briefs filed by the Commissioner in depreciation cases both under the 1939 Code and the 1954 Code, the Commissioner has also urged the definition of useful life which the taxpayer submits is correct.

A striking case is *Penn v. Commissioner of Internal Revenue*, 199 F. 2d 210 (8th Cir. 1952). There, the question was whether depreciation deductions on a building erected by a life tenant at her own expense were to be computed under Section 23(1) of the 1939 Code at a rate based upon the life expectancy of the life tenant, as the taxpayer claimed, or on the useful life of the building, as the Tax Court and the Court of Appeals held. At page 4 of the Commissioner's brief, the Commissioner stated:

"... Taxpayer points to nothing which supports her novel contention that annual deductions for depreciation of property are to be computed by a life tenant on the basis of his own life expectancy, rather than on the basis of *the useful life of the property itself.*" (Emphasis added.)

And, most significantly, at pages 10-11 of the Commissioner's brief, the Commissioner forthrightly and correctly refutes the very argument which he makes in the present litigation:

"The basic fallacy in taxpayer's argument lies in her assumption that 'depreciation' has reference to

the life of the owner of property, rather than to *the life of the property itself*. . . . Taxpayer's argument disregards not only the portion of Section 23(1) which deals specifically with property held by a life tenant, but the *general provision* that depreciation deductions are allowable 'for the exhaustion, wear and tear . . . of property'. *The wear and tear of 'property' has no relation to the life expectancy of its owner. On taxpayer's theory, every owner of a depreciable interest in property would be entitled to deduct annual depreciation at a rate based on the number of years he expects to live and enjoy the income from the property, instead of the number of years the property may be expected to produce income, a result repugnant to the fundamental concepts of depreciation.*" (Emphasis added.)

Both the court's holding and the Commissioner's position in *Penn* are antithetical to the Commissioner's new view of useful life in this proceeding and in his 1956 regulations.

Even more recently, in the Commissioner's "Respondent's Brief in Answer," submitted in 1958 to the Tax Court in the *Hillard* case, 31 T.C. 961 (1959), Docket No. 61604, one of his "Points Relied Upon" (page 17) is:

"It is respondent's position that where, as here, petitioner . . . leases [cars] *for substantially less than their normal useful life* . . . the gain from the sale thereof is taxable as ordinary income." (Emphasis added.)

Further, in the Argument, at page 18, the Commissioner refers to the "leasing [of cars] for substantially less than their normally useful life. . . ."

Another example of the Government's recent assertions of this accepted interpretation of the term "useful life" appears in the Brief for Appellee filed in the Sixth Circuit in *Cohn v. United States*, 259 F. 2d 371 (6th Cir. 1958), cited by the Commissioner at page 16 of his opening brief in this Court. There, in a refund suit involving depreciation for the years 1942-1944, the Government said (Docket Nos. 13,360-62, brief, page 8): "... on the other hand, if the asset will be disposed of long before its useful life has expired. . . ." And later, at page 27, the Government argued that the taxpayers in that case "... realized that the goods were to be disposed of, long before the expiration of the assets' useful lives. . . ."

Again in the *Cohn* case, the transcript of proceedings (included in the Appendix of Appellants) reveals the following testimony of the technical adviser in the Appellate Division of the Internal Revenue Service assigned to the case:

Page 245a: "In arriving at the useful life [of furniture, lockers and radio equipment] I considered first that all of this equipment was movable, that *unless it was of such specialized nature that it could not be used in any other business, the useful life of it should be determined by the life of the asset itself*; that a great deal of this equipment, in fact, substantially all of it, *could be used in other businesses*; for instance, the desks that they were using there *could be used anywhere*. I considered the fact that I had worked in offices for a number of years, and I know that the desks, even under the worst treatment, an oak desk would *last more than ten years*." (Emphasis added.)

This certainly is a forthright corroboration of the view that the useful life of an asset for depreciation purposes is its general business life—by whomever used. Further:

Pages 246a-247a: “. . . these partners were engaged in a sort of a war business, and there was some reasonable expectation, or there should have been, that perhaps . . . their business would not last the duration of the war, and that perhaps . . . they could—would dispose of this equipment before the end of its useful life.”

It appears impossible to square with that candid statement the Commissioner's arguments herein and the 1956 regulations' concept (Reg. Sec. 1.167[a]-1[b], Appendix A, *infra*, page 89) that useful life is “the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business. . . .”

The Commissioner's Fifth Circuit briefs in *Hillard*, 31 T.C. 961 (1959), now on appeal to the Fifth Circuit (Docket No. 17,915), are similarly revealing.

As to the four-year depreciable life used by the Commissioner on Hillard's cars, the Commissioner's Supplemental Brief for the Respondent (page 3) belatedly argues that the proper formula for depreciation “should have been” the expected period of usefulness in the particular taxpayer's business. (In his Respondent's Brief in Answer in the Tax Court, the Commissioner had made it a point [page 6] to show that “Petitioner sold his cars after a customary holding period of seven months to one year.”)

As to the general definition of “useful life,” the Commissioner's Brief for the Respondent (page 9) states, as the first point in his Argument:

"After Reviewing All the Evidence Before It, the Tax Court Correctly Found that Rental Vehicles Leased by the Taxpayer for *One-Fourth of Their Useful Life and Then Sold* Constituted Property Held 'Primarily for Sale. . . .' " (Emphasis added.)

At pages 18 and 19 of the Brief for the Respondent, the Commissioner says:

"The Tax Court recognized that when the taxpayer purchased the cars involved it was his intention to use them in the rent-a-car operation (R. 36) but, as the Tax Court also stated (*id.*), 'for a comparatively minor portion of their useful life and then to sell them.' * * * Those statements are amply justified by the evidence."

At page 4 of his Supplemental Brief for the Respondent, the Commissioner attempts this explanation:

"Since no issue of depreciation was here present, the Tax Court's statement (R. 36) that the taxpayer intended to use the cars in the rent-a-car operation 'for a comparatively minor portion of their useful life' obviously had reference only to the physical economic life of the cars."

What does appear obvious is that the Commissioner himself has equated the terms "useful life" and "physical economic life."

Indeed, the Government is still taking the long-established view of useful life in other cases under the 1954 Code. In *Highland Hills Swimming Club, Inc. v. Wiseman, District Director, and United States of America*, 59-1

USTC Para. 9284 (D.C.W.D. Okla. 1958), Docket No. 7672, (*aff'd* 272 F. 2d 176 [10th Cir. 1959]), the Government presented the question (brief, page 2) as follows: "Whether the Commissioner of Internal Revenue correctly determined that the taxpayer must depreciate its swimming pool over its physical life rather than the term stated in the lease [100 months], under the provisions of Section 167 of the Internal Revenue Code of 1954." And at page 9 of the Government's brief, the following statement appears: "The swimming pool had a useful life of 20 years. It is *not realistic* that the taxpayer only *contemplated its use* for approximately two-fifths of its useful life." (Emphasis added.) Is "useful life" the period of *contemplated use* by a particular taxpayer, as the Commissioner herein and new Reg. Sec. 1.167(a)-1(b) say it is? The last sentence of the above quotation appears to constitute a flat denial by the Government that that is the case.

Are we not justified in suggesting that the Government is shaping basic depreciation principles on an *ad hoc* basis in each case? In *Herbert Shainberg, et al.*, 33 TC No. 28, decided by the Tax Court on November 10, 1959, the taxpayers, who operated a shopping center, had claimed 200% declining balance depreciation, under Section 167 of the 1954 Code. There apparently was agreement that, on any theory of useful life, the assets involved all had useful lives of three or more years and were therefore eligible for such depreciation. Hence, once past the three-year eligibility question, the Government attempted to stretch out the useful lives of the assets involved in order to produce lower depreciation rates than those claimed by the tax-

payers. We believe the Commissioner's brief to the Tax Court in *Shainberg* (Docket Nos. 71618-20), filed on June 18, 1959 and signed by Arch M. Cantrall, Chief Counsel, Internal Revenue Service, speaks for itself:

"The *physical life* of the component parts of the buildings is a prime factor to be considered in determining the useful life of these assets. Presumably, unless other factors are present which would reduce the *physical life* of an asset, *there is no reason why the physical life and useful life would not be the same.*" (Page 54; emphasis added.)

Here is a clear admission by the Commissioner⁹ that the plaintiff's useful life is correct, for the "other factors"¹⁰ which would reduce an asset's *physical life* certainly do not include the taxpayer's projected holding period.¹¹

⁹ The particular operating practice of a taxpayer—as contrasted with his projected period of use—certainly may have important effects on the physical life of an asset. Thus the particular use may shorten the total period of economic usefulness materially—usually through abnormally heavy operation or undermaintenance. To the extent that such operating practice is proved (as opposed to merely proving the taxpayer's holding period), a taxpayer is permitted to adjust his depreciation rate accordingly. *Louis E. Whitham, et al.*, 10 TCM 250, 255 (1951). This well-established principle represents a faithful recognition of, and allowance for, the "variables" referred to by this Court in *Detroit Edison Company v. Commissioner of Internal Revenue*, 319 U.S. 98, 102 (1943).

Indeed, the Commissioner has advocated the principle in unmistakable terms in other places. In *W. N. Foster, et al.*, 2 TCM 595 (1943), the Commissioner—in the face of proof that an automobile was purchased in January, 1938 and sold in January, 1940—argued (Docket Nos. 110779, 110780, Commissioner's reply brief, pages 25-26) as follows: "In Bureau Bulletin 'F' the average useful life

Before the promulgation in 1956 of his regulations under Section 167 of the 1954 Code, the Commissioner's public pronouncements—Bulletin "F," revenue rulings and briefs submitted to the courts—have without exception defined the term "useful life" in a way consistent with the taxpayer's views as to the meaning of that term. Indeed, the taxpayer has shown that even after the promulgation of his 1956 regulations, the Commissioner has taken a position in briefs filed with the courts inconsistent with his contentions in this case.

With nothing in the applicable regulations, rulings or decisions to sustain the Commissioner's present claims as to the meanings of useful life and salvage value, it is understandable that he would like this case to be decided on the basis of his newly evolved concepts in the 1956 regulations (Appendix A, *infra*, pages 89-91). The Commissioner's attempt to read those regulations into the case at bar, after the fact, appears clearly in the table appearing at page 48, *infra*.

As the Ninth Circuit pointed out below:

"There can be no dispute over the fact that the Tax Court applied to the facts of this case definitions of 'useful life' and 'salvage value' which appeared for the first time in Regulations T.D. 6182, promulgated under the 1954 Code. The Commissioner does not seriously argue otherwise." (264 F. 2d at 506; R. 106.)

(Footnote 9 continued.)

of a passenger automobile used in business (other than be [sic] salesmen) is 5 years. Petitioners have not proved that the automobile was devoted to such *extraordinary uses* as to justify a higher rate of depreciation than that determined by respondent." (Emphasis added.)

From Commissioner's brief in the Ninth Circuit.

From the 1956 regulations (not applicable to the taxable years 1950 and 1951).

From the applicable regulations—111.

Page 7: "... [T]he Commissioner contends that, for the purpose of computing a reasonable depreciation allowance pursuant to Section 23(1), *the estimated useful life over which an asset is to be depreciated by a taxpayer is not necessarily the useful life inherent in the asset, and in the present case is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business.*" (Emphasis added.)

[This language is repeated in substantially identical manner at page 18 of the Commissioner's brief.]

PP. 7-8: "Similarly, it is submitted that *salvage value*, as that term is used in the Treasury Regulations interpreting Section 23(1), *means the amount (determined at the time of acquisition) which it is reasonable to estimate will be realizable upon the sale or other disposal of the asset when it is no longer useful in a taxpayer's business and is retired from service.*" (Emphasis added.)

[This language is repeated in substantially identical manner at pages 18-19 of the Commissioner's brief.]

Reg. Sec. 1.167(a)-1(b) [in part]: "For the purpose of section 167 *the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income.*" (Emphasis added.)

[No definition of useful life is given in the applicable regulations.]

Reg. Sec. 1.167(a)-1(c) [in part]: "*Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer.*"

[No definition of salvage value is given in the applicable regulations.]

4. *Expert Testimony.*

At the trial, the taxpayer called two expert witnesses, certified public accountants, who are members of two of the country's outstanding accounting firms. In both cases, their testimony was based on many years of cumulative experience in public accounting (R. 83-84, 88-89).¹⁰

Drawing on this experience in applying the depreciation provisions of the federal income tax statutes and regulations, Paul F. Johnson, of Ernst & Ernst, testified that the term "useful life," as applied in the setting of depreciation rates, means the economic or physical life of an asset; that in his experience in dealing with representatives of the Internal Revenue Service, that term was used in its "accepted accounting meaning" of economic or physical life; that the term "salvage value" meant the junk or scrap

¹⁰ With respect to the testimony of these accountants, the Commissioner says (Brief for the Petitioner, page 30):

"Commenting on similar expert testimony which had been offered in the *Hertz* case, the Third Circuit pointedly observed (268 F. 2d at 608-609) that the standard work on tax accounting, edited by four partners in the accounting firm of Lybrand, Ross Bros. & Montgomery, is directly to the contrary. *Montgomery's Federal Taxes* (37th ed. (1958)), c. 6, p. 4."

We note first that the Third Circuit did not, either at 268 F. 2d 608-609 or elsewhere in its opinion in *Hertz*, call the cited text "the standard work on tax accounting."

Further, not only were the authors of the text not produced for cross-examination at the trial, but an examination of the cited pages makes it quite apparent that these authors were simply reporting the opinions of lower courts in the depreciation litigation *now before this Court*, and their remarks may in no sense be taken as contradictory to the testimony of the accountants.

value of an asset—a value which is normally “negligible in the overall evaluation”; and that, if the Internal Revenue Service is now contending that the useful life of an automobile for depreciation purposes during 1950 and 1951 is the actual period during which the taxpayer held the automobile, and that salvage value is “average sales proceeds”, this is a change from the practice of the Internal Revenue Service during the period 1950 and 1951 and years prior thereto (R. 84-86).

On cross-examination, Mr. Johnson further explained that the physical or economic life of an asset is the period for which it will be useful to *someone*; that an asset may be put to more strenuous use in the hands of one taxpayer than in the hands of another, and that such use would make the physical life of that asset shorter than it would be in someone else's business; but that the useful life of an asset is the period for which it will be useful to someone (R. 87).

Raymond A. Hoffman, a partner in the firm of Price, Waterhouse & Co., testified that in his experience in approximately 20 years in business accounting, devoted primarily to federal income tax work, in dealing with representatives of the Internal Revenue Service no other meaning has been attached to the term “useful life” than “the physical life or economic life for the purpose for which a particular asset was intended by the manufacturer”; that the term “salvage value” is generally looked upon as synonymous with junk value at the end of the useful life of the asset; and that the contentions of the Internal Revenue Service in this case that useful life for automobiles in 1950 and 1951 was the actual period during which the

taxpayer held the automobiles, and that the salvage value was the average proceeds from the sale of the automobiles, represent a change of practice by the Service (R. 89-90).

It is significant that the Commissioner failed to offer any evidence to contradict the testimony of the taxpayer's experts. Furthermore, the record shows that their testimony remained unimpeached after the Commissioner's cross-examination (R. 86-88, 90-92).

It is well established that testimony of expert witnesses as to the correctness and prevalence of the administrative interpretation of a phrase involving accounting concepts, such as "useful life" and "salvage value", is particularly pertinent. The principle was recognized by this Court in *Willcuts v. Milton Dairy Company*, 275 U.S. 215 (1927), where the ordinary business meaning ascribed to a corporate accounting phrase was held to provide an authoritative interpretation of that phrase as used in the Revenue Act of 1918.

This Court recently applied the same rule in *The Colony, Inc. v. Commissioner of Internal Revenue*, 357 U.S. 28, 32 (1958):

"... statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them."

The only record evidence before this Court on the meaning of the term "useful life" is the experience of the taxpayer's witnesses, in dealing with Internal Revenue agents in the field under the 1939 Code, that useful life meant general business life, not an individual taxpayer's holding period (R. 85, 89).

The Ninth Circuit in its opinion below gave weight to the testimony given by the two certified public accountants at the trial in the Tax Court, saying:

"The long-continued and consistent practice and position of the Commissioner in measuring useful life by the physical or economic life of the depreciable asset were reflected in testimony before the Tax Court." (264 F. 2d at 511; R. 114.)

The position taken by the Commissioner in the decided cases (heretofore discussed) is contrary to his present position. The Commissioner's position in those cases was certainly known both to the accountants who testified and to the agents working in the field. If the Commissioner's counsel had been able to show that this was not the case, he could readily have called supporting witnesses from the government agency in possession of full knowledge of the facts—the Internal Revenue Service.

Thus, the law on useful life, as it stood during the taxable years in issue, and still stands, consisted of the following:

(i) A basic depreciation statute re-enacted many times, substantially unchanged, in successive revenue acts over a period of more than 35 years, in the light of, and without any significant change in

(ii) the Commissioner's basic depreciation regulations, which had been long continued in virtually identical form since 1918, and which

(iii) were consistently interpreted by the courts, and by the Commissioner himself, as applying and defining useful life as the life of an asset for general business purposes and not the period during which it happens to be held by a particular taxpayer.

That interpretation of useful life had the force of law by virtue of repeated re-enactment by Congress of the underlying legislation, under the principle of *Helvering v. Winmill*, 305 U.S. 79, 83 (1938):

“Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law.”

Accord: *Commissioner of Internal Revenue v. Flowers*, 326 U.S. 465, 469 (1946); *Boehm v. Commissioner of Internal Revenue*, 326 U.S. 287, 291-92 (1945); *Lykes v. United States*, 343 U.S. 118, 127 (1952); *Cammarano v. United States*, 358 U.S. 498, 510-11 (1959).¹¹

Prior to the promulgation in June, 1956, of regulations under Section 167 of the 1954 Code, the term “useful life” was consistently interpreted by the courts, the Commissioner and accountants to mean the physical life of the asset. Indeed, up to that time, disputes between the Commissioners and taxpayers invariably arose because the Commissioner was attempting to impose a longer period of depreciability (one measured by the useful life—the physical life—of the assets) than the taxpayer was willing to employ.

¹¹ In *Cammarano* (Nos. 29 and 50, October Term, 1958), it was the Government which argued (Brief for Respondent, page 11):

“The regulation in question, having been in existence for some forty years and during a period in which the underlying statutory provision has been repeatedly reenacted, has acquired the force of law.”

In the entire course of this litigation, the Commissioner (contrary to his assertion at pages 8-9 of his opening brief) has not offered a single citation of any case or ruling decided or published before the enactment of Section 167 of the 1954 Code in which he even contended (much less established) that useful life meant a taxpayer's holding period. It is significant that no such citation could be offered. One would think that in the course of decades of administering a statute which required thousands of taxpayers annually to determine for depreciation purposes the useful lives of their assets, the Commissioner would have at some point taken the position now being urged by him if, as he now contends, that has been the position right along. "Against the Treasury's prior long-standing and consistent administrative interpretation its more recent *ad hoc* contention as to how the statute should be construed cannot stand."¹²

II.

THE TERM "SALVAGE VALUE," FOR DEPRECIATION PURPOSES, MEANS THE RESIDUAL, JUNK OR SCRAP VALUE OF PROPERTY REMAINING AT THE END OF ITS "USEFUL LIFE," AS DEFINED ABOVE, NOT THE ESTIMATED PROCEEDS WHICH MAY BE REALIZED FROM THE DISPOSITION OF THE PROPERTY WHEN A TAXPAYER DISPENSES WITH IT BEFORE THE END OF ITS USEFUL LIFE.

The salvage value of an asset under any definition of useful life is a residual value—the asset's value upon the completion of the depreciation process at the end of its useful life. Thus, the present controversy over the mean-

¹² *United States v. Leslie Salt Co.*, 350 U.S. 383, 396 (1956).

ing of useful life carries with it a corollary controversy over the meaning of salvage value, which is the reciprocal of useful life.

The meaning of "salvage value", for depreciation purposes, emerges inevitably from the preceding discussion of "useful life". It is the residual, junk or scrap value of property left at the end of its physical "useful life." "Salvage value" is not the speculative amount which may be realized from the disposition of the property before the end of its useful life.

In accordance with the Commissioner's Regulations 111, Sec. 29.23(1)-1, depreciation over the useful life of the asset plus salvage value equals cost. Thus, salvage value is the reciprocal of useful life—the value remaining at the expiration of the inherent physical life of property, which, as we have demonstrated above, is the proper definition of "useful life". It is that part of a property's value which can never be destroyed by depreciation, that is, by exhaustion, wear and tear. The testimony of qualified expert witnesses shows that the business community regards salvage value as having such a meaning (R: 85, 87, 89, 90).

The Commissioner, having once departed (in his 1956 regulations and in recent litigation) from the established meaning of useful life, has naturally found it necessary to revise also the accepted meaning of salvage value.

But if useful life, as currently urged by the Commissioner, means something less than the period of substantially full exhaustion of the usefulness of the asset for general

purposes, the undepreciated balance after a particular *period of use* may be relatively substantial. This, in turn, leads to the introduction of a new factor—sales or market value of an asset which is not substantially exhausted or used up.¹³

As shown below, the factor of “market value salvage” has been consistently negated by the courts and by the Commissioner himself as an element in the determination of depreciation rates or the amount of depreciation which may be taken. The aggregate of depreciation and true salvage value—nominal or scrap or junk value—in the established method for determining depreciation cannot exceed the taxpayer’s cost or other basis. Fluctuations in the market value of depreciated assets—as contrasted

¹³ If this new factor and the Commissioner’s new opinion of “useful life” were accepted, they would undoubtedly produce interesting income tax litigation, in quantity, in the City of New York and other metropolitan centers where construction of office and other buildings is proceeding at a rapid pace. Suppose a building owner estimates that he will hold his building for five years and will then sell it. He estimates his sales proceeds as \$X. Will the Commissioner find fault—or be able to find fault—with a five-year projection of the amount which the building may bring at a time when booming real estate construction either may be continuing or may have wholly stopped? Is the Commissioner likely to allow a five-year useful life on a brand-new office building? If the owner estimates that he will get more than his original cost upon sale of the building after five years, is he entitled to no depreciation at all? If the owner believes that he will hold the building indefinitely, is the building’s useful life equal to his life expectancy (contrary to *Penn v. Commissioner of Internal Revenue*, 199 F. 2d 210 [8th Cir. 1952])?

with the exhaustion of their service capacity¹⁴—are reflected in the taxpayer's income, in the year of disposition, under Section 117(j) of the 1939 Code, or Section 1231 of the 1954 Code, in the sense that such fluctuations may affect the amount of his taxable gain or loss upon disposition of the assets.

The example at page 28, footnote 16 of the Commissioner's opening brief is plainly fallacious and irrelevant. It seeks to make a point by constructing a "recovery" through sales (at what the market happens to bring) and then injecting this "recovery" into a statutory standard which grants a deduction for "exhaustion, wear and tear," not reduction in market value. It simply confuses realization through sales (at what the market happens to bring) with "recovery" through depreciation deductions.

¹⁴ "It is true that a machine which has been installed and used for a few weeks is already second-hand and could be sold for perhaps not more than half its cost, although it may still have a service life of 10 years. But the machine is not being held for sale; it is being held for use, and if only 3 months have expired of its total service life of 10 years, then only 1-40 of its value to its owners has expired, and 39-40 of its value to them remains. The fact that its sale value might be less has nothing to do with the case. In other words, depreciation measures the exhaustion of service capacity in the assets; it does not measure the fluctuations of market prices of those or similar assets. It is well understood that if any question of the sale of the properties should arise, their current market value would become very important; but information on that subject would naturally be sought for outside the books of account." Thomas Henry Sanders (Professor of Accounting, Graduate School of Business Administration, Harvard University), *Industrial Accounting, Control of Industry Through Costs*, 147 (New York: McGraw-Hill Book Company, Inc., 1929).

This obvious error results from a confusion in concepts. But even using the Commissioner's own example, for the sake of argument, the dollars and cents result which he obtains (on the basis of the three variables which he chooses to use—purchase price, sale price and the depreciation deduction) should be as follows:

Cost	\$1650.00
Depreciation (fifteen months)	515.00
Combined normal tax and sur- tax (taxpayer's effective rate for 1950)	34%
Tax saving through depreciation	175.10
Unrecovered* investment	1,474.90
Sales price	1,380.00
Tax on gain (17%, or $\frac{1}{2}$ of 34%, of \$1,380.00 minus \$1,135.00 [depreciated cost])	41.65
Net sales proceeds	1,338.35
Unrecovered amount	136.55

(During the period under review, used car prices went up abnormally because of the Korean War and anticipation of shortages [R. 71]. Thus, a similar analysis of the record figures for 1952, 1953 and 1954, when prices became more normal, shows even greater unrecovered amounts for those years.)

The "total recovery" of \$2,078.75 and the "gain" of \$428.75 in the Commissioner's example are non-existent. Among other misleading procedures, the Commissioner, in arriving at \$2,078.75, has used the assumed sales price—\$1,380.00—once in its entirety and then has re-used \$183.75 of the same amount in arriving at the "total recovery."

Another crucial error in the Commissioner's example is that any so-called excess "recovery" would occur, *if the market were as relatively favorable as it happened to be during 1950 and 1951*, irrespective of the tax rate applied—whether the capital gain rate of Section 117(j), which is the obvious target of the Commissioner's new theories, or some other rate. If gains on the sale of business assets were taxed at the taxpayer's effective rate for 1950—34%—there would still be, using the Commissioner's computation, a "gain" of \$406.70, *despite the fact that every penny of depreciation claimed and allowed at the 34% rate would be picked up as taxable ordinary income, upon sale, at the same 34% rate.* (Even at the corporate rate of 42% in effect for the calendar year 1950, the Commissioner's assumptions would produce a "gain" of \$387.10.)

Thus, if we are to follow the Commissioner's computation, the only way in which such so-called excess "recovery" could be avoided would be by imposing a 100% tax on the "profits" realized on the sale of business property.

But the Commissioner has himself recognized in *Hertz*, No. 283, this Term, that "... the sale price might supply the undepreciated cost; this, however, would not be a recovery through depreciation, but through relatively more profitable sales." (Docket No. 12,799, Third Circuit Brief for the Appellant, page 25, footnote 6).

Briefly, what the Commissioner is trying to do is to trim the depreciation deduction at both ends: greatly to reduce the actual depreciable life of an automobile, and greatly to reduce the amount which can be depreciated by calling

the resale value of the automobiles their salvage value. His proposed innovations have no basis under the cases, in his own practice, in the practice and understanding of accountants or in his own bulletins and regulations.

1. *The case.*

The claim that salvage value is measured by, or has any relation to, sales proceeds of an asset disposed of long before the end of its usefulness¹⁵ was rejected many years ago because it was contrary to logic and authority. For example, in *Reginald Denny*, 33 B.T.A. 738 (1935), the Board of Tax Appeals, in determining depreciation on an airplane, stated:

"From the [taxpayer's] testimony, we gather that he regarded shrinkage of market value as synonymous with loss of useful value. *The two are rarely, if ever, the same.*" (33 B.T.A. at 743; emphasis added.)¹⁵

In *Louis Titus*, 2 B.T.A. 754 (1925), Acq. V-1 CB 5, the taxpayer argued that because he had to buy second-hand office equipment in 1917 at inflated prices, and disposed of it at a considerable loss in 1920, his claimed 20%-a-year depreciation rate was not excessive. The Commissioner and the Board of Tax Appeals disagreed (2 B.T.A. at 758):

¹⁵ This case is also of interest on the issue of the meaning of useful life. Denny bought his airplane "in 1924" and disposed of it "in the early part of 1926" (33 B.T.A. at 739, 740). Although his holding period was thus about two years, the Board held that a 20% rate (five-year life) would be a reasonable allowance for depreciation, and his claimed 40% rate (two-and-a-half-year life) was disallowed.

"In determining the annual depreciation to be allowed, consideration can not be given to the fluctuations in cost or value of the assets which may take place from year to year owing to market conditions. The fact that second-hand furniture sold at a high figure in 1917 and at a low figure in 1920 can not, therefore, be taken into account in determining the rate of depreciation which should be allowed the taxpayer."

(Moreover, despite the fact that the taxpayer owned the equipment only three years, not only did the Commissioner and the Board reject the taxpayer's claimed 20% rate, but they held that a 10% rate—10-year useful life—was correct. That action clearly contravenes the Commissioner's current opinion as to the meaning of useful life.)

A case cited by the Commissioner in the Ninth Circuit proceeding below (Brief for the Respondent, page 46) directly supports the taxpayer's position on salvage value. Commenting on *W. Harace Williams Company, Inc.*, 56-2 U.S.T.C. Para. 9839 (D.C.E.D. La., 1956), affirmed without discussion of this point, 245 F. 2d 559 (5th Cir. 1957), the Commissioner's brief states:

"In that case the salvage value of a particular asset [the barge *Cap*, a converted LST], in 1948 and 1949, was \$50,000. In 1950, the tax year in question, the salvage value fluctuated from zero to \$30,000. The court found that an estimated value of \$30,000 was fair and reasonable and the depreciation allowance for 1950 was adjusted accordingly." (Pages 46-47, footnote 27, Commissioner's brief.)

The Commissioner's truncated version of the court's holding in the *Williams Company* case could well produce a

mistaken impression. Actually, the case fully supports the taxpayer. Finding of Fact No. 29 in that case reads, in full:

"The salvage value of the Barge *Cap* at various times during 1950 ranged from zero to \$30,000, *fluctuating with the price of and demand for scrap.*" (Emphasis added.)

In *Pilot Freight Carriers, Inc.*, 15 TCM 1027 (1956), as in the case at bar, the Commissioner argued that the useful lives claimed by the taxpayer for tractors and trailers were erroneously computed because, upon sale by the taxpayer, the latter received "amounts largely in excess of the depreciated cost thereof" (15 TCM at 1032). The court rejected that argument, citing, from *Wier Long Leaf Lumber Co.*, 9 T.C. 990 (1947), Acq. 1948-1 CB 3 (reversed on other issues, 173 F. 2d 549 [C.A. 5th, 1949]), this principle:

"The sole fact therefore in any specific situation that a given price is received for articles not fully depreciated throws no light on the effect upon the depreciation allowance." (9 T.C. at 999.)

One illogical offshoot of the Commissioner's new views appears in *Cohn v. United States*, 259 F. 2d 371 (6th Cir. 1958), which is included in a list of citations appearing at page 16 of his Brief for the Petitioner herein. According to *Cohn*, if a depreciable asset is sold during a taxable year for more than its depreciated basis as of the beginning of that year, no depreciation is allowable on the asset for that year. Understandably, the Commissioner is now treading lightly on *Cohn*, which, he urged on oral argu-

ment below, supported his position; for *Cohn* focuses sharply, we believe, on a key weakness in the Commissioner's new theories.

Let us suppose that Taxpayer X buys two new items, identical punch presses, for the same price, on the same day—January 1, 1950. (The rate of depreciation is immaterial.) After the presses have been in continuous use for the same purpose and at the same rate of operation in X's business, X sells one of the presses on December 1, 1953 for an amount *less* than its depreciated cost on January 1, 1953. On December 15, 1953 he sells the other. For any one or more of a host of reasons—a strike, a war scare, better prospects in industries using that kind of press, the sudden need of a buyer with unexpected orders, or the like—X gets a price for Press No. 2 *more* than its depreciated cost on January 1, 1953.

Cohn's viewpoint is that X may have *full* depreciation on Press No. 1 for eleven months of 1953, but *zero* depreciation on Press No. 2 for eleven months and 15 days of 1953, despite the fact that the "exhaustion, wear and tear" of the two machines—*i.e.*, that for which the statute offers a deduction—has, of course, been virtually identical.

There could hardly be a better demonstration of the Commissioner's new market value theory of depreciation and of that theory's divergence from the statutory standard.

Reversing his stand of long duration, the Commissioner now chooses to ignore the point that federal income tax depreciation is based on the annual loss of value resulting

from exhaustion, wear and tear, which are physical facts. Under the Commissioner's new theories, the starting point in determining the amount of depreciation allowable is the amount realized by the taxpayer on disposition of his automobiles. But it is clear that such amounts were not determined by the physical facts of wear and tear of his automobiles. In this case, those amounts were basically determined by reference to the automobile dealers' handbook of values (N.A.D.A. book), which is revised every 30 days (R. 58, 60). The amounts realized by the taxpayer were merely whatever happened to be the market values at a particular period of time in the physical life of the cars.

2. *The Commissioner's pronouncements.*

In quoting the applicable depreciation regulations at Appendix A, page 37, of his Brief for the Petitioner, the Commissioner has himself pointed up the fact that market fluctuations have nothing to do with depreciation:

"For convenience such an allowance [i.e., the statutory depreciation allowance] will usually be referred to as depreciation, excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear, or obsolescence." (Regulations 111, Sec. 29.23[1]-1; emphasis added.)¹⁶

¹⁶ It is significant that this express limitation did not appear in the preliminary draft of the regulations under the Revenue Act of 1918 (see page 48 of House Document No. 1826, 65th Cong., 3d Sess., referred to in the Commissioner's brief, page 20, footnote 8), but was deemed important enough to add to the final form of the regulations.

The cases have made it clear that of course the limitation also applies in the converse situation—where there is an actual appreci-

The reason for this express exclusion from the depreciation concept of the nebulous factor of future sales proceeds has been well stated by the Commissioner himself. In its opening brief to the Third Circuit in *Hertz*, No. 283, this Term, the Government frankly admitted (pages 28-29, footnote 9):

"It is true . . . that this recovery might be improved somewhat by the fact that a resale of the asset at an earlier date would result in a resale price higher than estimated salvage value. The amount of such recovery on the resale is *purely conjectural, however, based as it necessarily is upon the saleability of the asset, the conditions of the particular business and business conditions in general. In any event, a recovery through higher resale is not a recovery through depreciation.* . . ." (Emphasis added.)

(Footnote 16 Continued)

ation in market value. For example, in *Max Eichenberg*, 16 B.T.A. 1368 (1929), the taxpayer owned a depreciable building for seven years, but claimed a depreciation deduction only during the last year. He argued that since he sold the building for more than his original cost, no depreciation was sustained (and that his basis upon sale was therefore virtually unimpaired). This argument was rejected (16 B.T.A. at 1370):

"[Taxpayer contends] that any physical depreciation of the brick business house was more than compensated by appreciation resulting from increase in the cost of building materials during the term of his ownership. We have heretofore held that for the purpose of computing profit from the sale of depreciable property sustained depreciation may not be offset by appreciation in the market value of the property involved. This issue is controlled by our decisions in *Even Realty Co.*, 1 B.T.A. 355, and *Seton Falls Realty Co.*, 6 B.T.A. 883, which have been fully sustained by the Supreme Court in *United States v. Ludey*, 274 U.S. 295."

We note two things: First, the Government admits that the direction of Reg. Sec. 1.167(a)-1(c) of the 1956 regulations (Appendix A, *in/ra*, pages 90-91) that salvage value be estimated as the amount realizable upon sale is a direction to guess at a "purely conjectural" amount. Moreover, if recovery through resale is not recovery through depreciation, what can sales proceeds have to do with the basic theory of depreciation?

Although obviously not of controlling importance, the fact is that, so far as we have been able to ascertain, none of the individual or corporation income tax return forms over the years (currently Forms 1040 and 1120, respectively) has ever specified salvage value as an item to be set forth in the schedule requiring an explanation of the deduction for depreciation. This is true despite the fact that the depreciation schedule has uniformly required submission of detailed data on date of acquisition of the property, cost, depreciation allowed or allowable in prior years, life and other items.

In at least one place in the Treasury's tax regulations, the Commissioner has expressly equated "salvage" with scrap or junk. From 1940 to 1958 (thus including the taxable years under review); the federal excise tax regulations contained the following definition:

"The term 'manufacturer' includes a person who produces a taxable article from scrap, salvage, or junk material, as well as from new or raw material, (1) by processing . . . [etc.] . . ."

(Promulgated January 8, 1940 in Regulations 46, 5 F.R. No. 7, January 11, 1940, 142, 143, 26 C.F.R. [Cum. Supp. 1944] Part 316, §316.4.)

This usage accords with the following view:

"Salvage is not regarded as a proper description of the proceeds received in the case of sales, fire losses, or other 'abnormal retirements' . . ." (Emphasis added.)

(American Bar Association, Section of Taxation, 1959, Program and Committee Reports to be presented at the Twentieth Annual Meeting of the Section to be held August 20-25, 1959, Miami, Florida, Report of the Committee on Depreciation and Amortization, page 38.)

• Regulations under the 1939 Code for many years before 1954 described depreciation as "excluding from the term any idea of a mere reduction in market value not resulting from exhaustion, wear and tear or obsolescence." (Reg. 111, Sec. 29.23[1]-1.) The Commissioner's new salvage value theory in this case is therefore wholly inconsistent with his own pronouncements. He has asked the Court herein to equate market value at the time of disposition of taxpayer's cars with salvage. Such a request cannot be squared with the regulations governing this case.

3. *Congressional intent.*

Congress itself has recognized that the taxpayer's sales proceeds may be substantially in excess of salvage value. That sales proceeds are not equivalent to salvage value appears clearly in the legislative history of Section 117(a) of the Revenue Act of 1938 (52 Stat. 447, 500), which excluded depreciable business assets from the category of capital assets so as to permit taxpayers to obtain ordinary (instead of capital) losses on sales of such assets. At pages 34-35 of House Report No. 1860, 75th Cong., 3rd

Sess., accompanying the Revenue Bill of 1938, the House Ways and Means Committee stated (1939-1 CB [Part 2] 752-53):

"Suppose that X, a manufacturer, purchased in 1932 a large machine, at a cost of \$50,000. At the time of acquisition and installation in his plant, the machine had an estimated useful life of 10 years. X was therefore allowed an annual deduction from gross income for depreciation on the straight-line method of one-tenth of the cost, or \$5,000, with respect to this machine. Assume that in 1938, when the machine has been in use for six years, a new and improved type of machine is introduced, the installation of which would materially reduce X's costs of production. X has, however, recovered only 60 per cent of the cost of the old machine through the annual deduction for depreciation. Let it be further assumed that X could sell the old machine to Y, another manufacturer, for \$7,500, which is only 15 per cent of its cost to X, *but is materially in excess of its junk or salvage value*. If such a sale were consummated, X would sustain an actual loss of \$12,500 on this machine." (Emphasis added.)

If the proceeds of sale are higher than the asset's depreciated cost, they are subject to a capital gains tax. If they are lower than the asset's depreciated cost, the taxpayer may take the loss as an offset against ordinary income. If the availability to the taxpayer of this result displeases the Commissioner of Internal Revenue, the source of his displeasure is Congress, not the taxpayer. The latter merely uses the doors intentionally left open for him by a Congress intent upon giving him this benefit for the sake of the economy as a whole.

The sum of the deductions for depreciation plus salvage value equals recovery by depreciation. What the taxpayer happens to receive upon the *sale* of the asset is not recovery by depreciation.

Upon analysis, it appears that the Commissioner's new theory of depreciation embodies the philosophy of providing an allowance for the decline in the market value of an asset during the period in which it happens to be used by a particular taxpayer. Under this theory, the cost of the asset, less the amount for which he anticipates selling it, constitutes the taxpayer's basis for depreciation. This basis is to be written off during the period in which he holds the asset. In brief, the sum to be depreciated, under this new theory, is essentially the difference between two market value figures—the first derived when the taxpayer purchases the asset and the second when he sells it.

But depreciation is an accounting concept and not a market concept. It measures, and is intended by Congress to measure, value decline only in terms of the erosion of usefulness by exhaustion, wear and tear. For example, depreciation certainly goes on and is allowed even in periods of extraordinary demand when used assets appreciate in market value. The Commissioner's holding-period-sales-proceeds approach in the case at bar and in *Hertz*, No. 283, this Term, may provide an arithmetical measure of something, but it is not a measure of the exhaustion, wear and tear of the asset.

In the case at bar, as in *Hertz*, the Commissioner attempts to sustain his position that without his new defi-

dition of salvage value a taxpayer might recover, by deductions for depreciation, almost the full cost of an asset and then sell the asset in a favorable market at a price which brings him more than salvage value.

To this a series of answers presents itself:

(1) The taxpayer must pay a tax out of any profit thus realized.

(2) He need pay only a capital gains tax because Congress chose to apply only the capital gains tax in order to encourage the earlier sale of depreciable assets, and the purchase of new assets, with attendant advantages for the economy.

(3) Such profit—if and when obtainable—results from *something which has no connection with depreciation: the state of the market*. Should the taxpayer be required to forecast the state of the market for goods which he may sell after a period of years, the length of which period he cannot prognosticate because of admittedly unpredictable factors (R. 65, 66-67, 69-71)?

True, depreciation deductions over the full useful life of an asset plus salvage are not permitted to total more than original cost. And just as it is substantially easier to estimate the full useful *life* of an asset than it is to estimate the length of time a given taxpayer will *use* that asset before selling it, something of the same considerations make it much easier to estimate *salvage*—scrap, junk or residual physical—value than to estimate what the asset will bring, after an unknown period of use, when it is sold by reason of unpredictable factors. The state of the

second-hand market in that asset may itself dictate the date of sale. A new invention may dictate the date of sale. Ordinary wear and tear—real depreciation—may dictate the date of sale. Or unexpected competition, or unexpected weather, or an unexpected strike, or a variety of other factors may dictate the date of sale.

III.

THE PROPER FORUM FOR THE COMMISSIONER'S ARGUMENTS IS CONGRESS, NOT THE COURTS, FOR THE COMMISSIONER'S REDEFINITIONS OF USEFUL LIFE AND SALVAGE VALUE ARE INTENDED TO ABROGATE, BY ADMINISTRATIVE ACTION, SECTION 117(j) OF THE 1939 CODE AND SECTION 1231 OF THE 1954 CODE.

As indicated at the beginning of our argument, it seems clear that what the Commissioner is trying to do in this case is to assert a new definition of "useful life" which, in conjunction with his new definition of "salvage value," would mean that, generally speaking, taxpayers would not be able to avail themselves of capital gains upon the sale of business assets under Section 117(j) of the 1939 Code (or its successor, Section 1231 of the 1954 Code).

As we have pointed out above (page 11), the Commissioner, in his deficiency notice (R. 12), originally contended that any gain realized by the taxpayer from the sale of his automobiles was includible in the taxpayer's returns not as capital gain, as reported, but as ordinary income—on the theory that the taxpayer was a dealer in automobiles. In his brief before the Tax Court, the Commissioner abandoned that contention and conceded the taxpayer's right, under Section 117(j) of the 1939 Code, to treat sales of his

automobiles as sales of property used in his trade or business, not held primarily for sale to customers in the ordinary course.

But that concession is meaningless if this Court accepts the Commissioner's new definitions of useful life and salvage value, since the Commissioner's argument in this case is designed to achieve administrative repeal of Section 117(j) and the 1954 Code provision, Section 1231. Indeed, the Commissioner's counsel admitted as much at the hearing before the Tax Court when he stated:

"... our position is somewhat in the alternative because we have adjusted the useful life and we have adjusted the depreciation and in taking that action we have cut down the amount of gain or profit considerably." (R. 40.)

The Treasury has tried several times to prevent the realization of capital gains on the sale of depreciable business property under Sections 117(j) and 1231 in other ways—without success. In the light of the history of those provisions, it is astonishing to see the Commissioner continuing his efforts arbitrarily to vitiate them.

The Treasury's first attempt occurred during the extensive Revenue Revision hearings held by Congress in 1947 and 1948, when the Business Tax Section of the Division of Tax Research of the Treasury Department submitted a report on accelerated depreciation to the Ways and Means Committee of the House of Representatives ("Revenue Revisions, 1947-1948", hearings of December 2-12, 1947, Part 5, page 3756), in which the Treas-

ury Department attempted to reduce the effect of the capital gains section in the 1939 Code (Section 117 [j]), stating:

"[A] danger is that accelerated depreciation allowances might be used to convert ordinary income into capital gains, since a businessman might sell a fully depreciated asset that still had a substantial value, paying a tax on the capital gain and avoiding the taxes on its income that were deferred during the period of accelerated depreciation. This type of avoidance could be overcome by requiring that if the taxpayer elects to use accelerated depreciation, gain to the extent of the excess of accelerated over normal depreciation must be treated as ordinary income."

This initial straightforward attempt by the Treasury Department to change the design of the statute authorizing capital gain treatment for profits realized from the sale of assets subject to accelerated depreciation failed because Congress was adhering to the above-described policy of encouraging the sale of capital equipment and thus encouraging the purchase of new capital equipment.

In its second attempt, shortly thereafter, the Treasury Department took a different approach in its attack on Section 117(j). It recommended to Congress in 1950—one of the taxable years here under review—that losses on the sale of depreciable business property be treated as capital rather than ordinary losses. On February 3, 1950, Secretary of the Treasury Snyder told the House Ways and Means Committee:¹⁷

¹⁷ Hearings before the Committee on Ways and Means, House of Representatives, 81st Cong., 2nd Sess., "Revenue Revisions of 1950," Volume 1, page 20.

"Another important loophole provides a 'one-way street' for taxpayers selling property which they have used in their trade or business. At the present time, such taxpayers are allowed capital-gains treatment when the sales result in a net gain, while net losses from such transactions are allowed in full as offsets against ordinary income."

Secretary Snyder referred, at the same page, to Exhibit 4 to his statement—a list of "Miscellaneous Tax Loopholes" prepared by the staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation. This exhibit stated, in part:¹⁸

"The justification which the section [117(j) of the 1939 Code] might have had at the time of its enactment is believed to have disappeared with the termination of the war."

But Congress refused in 1950—as it refused in 1954 and still refuses—to eliminate the so-called one-way street in the taxation of gains on the sale of business property.

The third attempt by the Internal Revenue Service to limit capital gain treatment for gains from the sale of depreciable property took the form of a contention, under Section 117(j) of the 1939 Code, or Section 1231 of the 1954 Code, that the assets in question were held "primarily for sale to customers in the ordinary course of [taxpayer's] trade or business" and that profits on such assets' sale thus were ineligible for capital gain treatment.

¹⁸ Hearings before the Committee on Ways and Means, House of Representatives, 81st Cong., 2nd Sess., "Revenue Revisions of 1950," Volume 1, page 71.

That attempt also failed. That approach was closed off in the *Philber* case, 237 F. 2d 129 (3rd Cir. 1956), discussed *supra*, pages 27-28, and abandoned by the Commissioner in Rev. Rul. 54-229, 1954-1 CB 124, and in this case below.

The Commissioner's current contention represents a fourth approach, a back door through which the Internal Revenue Service hopes to be able to strike down or substantially impair capital gain treatment of such profits. The latest attempt is to claim that the useful life of business automobiles is not the usual and accepted period of four years, but is a year and a half or two years. If salvage value is then defined as meaning whatever amount the taxpayer can get for an automobile at the end of that shortened period, there is relatively little asset value left to depreciate, and there can be little or no capital gain.

The Commissioner's true objective here is to defeat the application of Section 117(j) and, in defiance of Congressional purposes, to prevent the realization of capital gains thereunder. If that result cannot be effected in any other way, apparently the Commissioner has decided that it must be done by way of upsetting the accepted definition of useful life, imposing an arbitrary salvage value limitation upon the taking of depreciation—*anything* to defeat the express statutory mandate that gains on the sale of business property shall be taxed at capital gain rates.

For although this case is in form a technical dispute about depreciation, it is, in substance, another of the Treasury Department's continuing—and thus far unsuccessful—attempts to limit, without Congressional sanction,

the application of Section 117(j) of the 1939 Code (now Section 1231 of the 1954 Code), which permits capital gain treatment of profit on the sale of depreciable property held for more than six months. The Government has said as much. At page 40 of the Government's opening Third Circuit brief in *Hertz*, No. 283, this Term, appears this frank statement:

"The simple fact is that the profit is taxable at capital gains rates and taxpayer, under its view, receives the benefit of a deduction at a 52% rate and pays tax on the profit resulting from the increased deduction at a 25% rate. *This result can be avoided* by defining useful-life for purposes of depreciation as meaning the period during which an asset is useful to the taxpayer (together with a reasonable computation of salvage value). *This has been done* in Section 1.167(a)-1(b) of the Regulations." (Emphasis added.)

This down to earth language brings the real issue into the open; it is a candid admission that the Treasury is attempting to repeal—or at least severely limit the application of—Section 1231 of the 1954 Code by the issuance of specially tailored regulations under Section 167, and to do the same to analogous Section 117(j) of the 1939 Code by taking the same position in open years under the latter Code.

The same admission has recently been made at a very high level in the Treasury. In the February, 1959 number of the *Journal of Taxation*, Mr. Darrell S. Parker, Chief of the Engineering and Valuation Branch of the Internal Revenue Service, writes:¹⁹

¹⁹ 10 *Journal of Taxation* 69, 70.

"It is evident that Section 1231 is the principal cause of the examining agent's investigation of the salvage question. It is common knowledge that consideration was given in 1958 by Congress to a proposal that the lives of various groups of depreciable assets be reduced and, if the taxpayer elected to use the group life for which it qualified, the treatment under Section 1231 would be waived upon all disposal of depreciable property included within such group."²⁰

These considerations are, of course, in the highest degree, proper subjects for *legislative* action.

But the Commissioner in this case is attempting to assert a new *administrative* definition of "useful life" which,

²⁰ Indeed, Congressional leadership has considered the problem as one for legislative solution. The present Chairman of the House Ways and Means Committee, Wilbur D. Mills (then Chairman of that Committee's Subcommittee on Internal Revenue Taxation), in a speech made before the American Bar Association's Section of Taxation on August 25, 1956—shortly after promulgation of the 1956 regulations—stated:

"The fact that the new [1954] Code has substantially altered the 1939 Code in [certain] areas has, of course, left unresolved pressing substantive issues. Indeed, many of these issues have been brought into sharper focus by virtue of changes elsewhere in the Code. For example, *the accelerated depreciation methods incorporated in section 167 have changed the perspective in which the revenue consequences, the economic impact and equity considerations of section 1231—old section 117(j)—must be viewed.* A major order of business for the Subcommittee on Internal Revenue Taxation, therefore will be to cover ground not adequately or successfully explored in the 1954 revision." (Emphasis added.)

(Section of Taxation Bulletin, October 1956, American Bar Association, pages 9-10.)

when combined with his new definition of salvage value, would result in a disallowance to taxpayers of capital gains upon the sale of business assets under Section 117(j) of the 1939 Code.

Congress has not changed its mind.

When Congress was considering the 1954 Code, the question of capital gains on the sale of business property was specifically brought to its attention by the Committee on Federal Taxation of the American Institute of Accountants. On April 19, 1954, that group filed with the Senate Finance Committee its Recommendation No. 180 with respect to Section 1231 (Hearings before the Committee on Finance, United States Senate, 83rd Cong., 2d Sess., on H. R. 8300, Part 3, page 1324), as follows:

"Gain or loss on property used in the trade or business, etc., should be treated uniformly as ordinary income or loss."

But Congress rejected this recommendation because it wished to encourage businessmen to sell capital assets earlier than they might otherwise sell them and, by paying the lesser capital gain tax rates on the profit that might be realized, be in a better position to buy new capital assets to take their place.

Congress made it clear in 1954, as it had made it clear before, that Section 117(j), the provision in the 1939 Code for capital gain treatment of profits on the sale of business property, was not being disturbed in the 1954 Code. Page A275 (3 U.S.C. Cong. & Adm. News [1954] 4417)

of House Report No. 1337, 83rd Cong., 2nd Sess., on H. R. 8300, states, with respect to Section 1231:

"This section is derived from section 117(j) of the present law. There is no substantive change intended but some rearrangement has been made."

Indeed, Congress said this in the face of explicit opinion that the combination of the new depreciation methods and the capital gain provisions of Section 1231 might well "accentuate" the advantage—already existing under the 1939 Code—of the favorable capital gain tax rate over the standard-income tax rate.²¹

It is highly significant that Congress limited capital gains on sales of emergency facilities in Sections 124A and 117(g)(3) of the 1939 Code (Sections 168 and 1238 of the 1954 Code); and yet left untouched Sections 23(1) and 117(j) (Sections 167 and 1231 of the 1954 Code), sections controlling this case and applicable to ordinary depreciable property.²²

²¹ See remarks of Representative Curtis, of Missouri (a member of the House Ways and Means Committee), on H.R. 8300 at 100 Cong. Rec. 3678 (March 22, 1954).

²² Other examples are indicated in Surrey, "Definitional Problems in Capital Gains Taxation," *Tax Revision Compendium, Committee on Ways and Means, November 16, 1959*, 1203, 1211 (footnote 26):

"For example, World War II 5-year amortization under Internal Revenue Code of 1939, sec. 124, added by 56 Stat. 849 (1942), left the asset a capital asset; under Korean war 5-year amortization, the asset became an ordinary asset to the extent of the excess of amortization over ordinary depreciation, sec. 1238; 5-year amortization of grain storage facilities under sec. 169 permits capital gain on the sale of the facility; rapid depreciation under sec. 167(b) leaves the asset a capital asset. Sec. 1239

The Commissioner is still nevertheless trying to do, by litigation and in the 1956 regulations, what Congress refused to do when that very question was specifically put before it.

Indeed, the President's budget message to Congress of January 18, 1960 revealed yet another proposal for legislation limiting capital gain treatment on the sale of depreciable business property:

"Under existing law, administration of the depreciation provisions is being hampered by the attempts of some taxpayers to claim excessive depreciation before disposing of their property. If gain from the sale of depreciable personal property were treated as ordinary income, the advantage gained in claiming excessive depreciation deductions would be materially reduced and the taxpayer's judgment as to the useful life of his property could more readily be accepted. Accordingly, I recommend that consideration be given to a change in the law which would treat such gain as ordinary income to the extent of the depreciation deduction previously taken on the property." (The Budget of the United States Government for the Fiscal Year ending June 30, 1961, page M11; Congressional Record, January 18, 1960, page 583.)

(Footnote 22 continued)

prescribes ordinary income treatment for sales of depreciable property between shareholder and corporation in certain family settings; sec. 707(b)(2) is a similar provision relating to sales between a partnership and a partner.

"In addition, the Commissioner has attempted to meet this general problem by limiting the amount of the depreciation deduction through a definition of useful life that takes account of the probable sale of the assets and through a measure of salvage value that takes account of the value at sale. See *Hertz Corporation v. United States* —, F2d — (3d Cir. 1959)."

Even more revealing is the letter of February 12, 1960 from the Secretary of the Treasury to the Vice President and the Speaker of the House of Representatives (reproduced in full at Appendix B, *infra*, pages 92-93), transmitting proposed legislation to implement the President's recommendation. The letter says, in part:

"The proposed statutory change which would require that gains from sale of depreciable personal property be treated as ordinary income, to the extent of depreciation previously claimed, would make it possible for agents of the Internal Revenue Service to accept more readily taxpayer judgments and taxpayer practices with respect to depreciation rates and salvage value. In short, if enacted the proposed legislation, by eliminating the opportunity which now exists of converting ordinary income into capital gains, would contribute to the sound administration of the depreciation laws."

Why should the proposal make it possible for Internal Revenue agents to accept "more readily" taxpayer judgments and taxpayer practices on depreciation—unless, as is clearly the case, the Commissioner is administering the depreciation deduction not on the basis of the statutory standard of "exhaustion, wear and tear," but on the basis of how much capital gain a given depreciation rate will produce. With or without the legislation which the Treasury now asks, the depreciation statute remains the same, and in the absence of Congressional action is not to be administered in different ways depending on whether another statute remains in force or is discarded.

Congress may, if it wishes, eliminate capital gain treatment following depreciation of business property, which the Treasury admits "now exists"; the Commissioner may not do so by accepting "more readily" or less readily depreciation principles established for decades under the statute, cases, regulations and the Commissioner's own pronouncements.

The proper forum for the arguments advanced by the Commissioner in the case at bar is Congress, not the courts. The many thorough studies by legislative committees²³ and others²⁴ on possible changes in the depreciation and capital gain provisions of the present Internal Revenue Code point the way for Treasury action through the accepted procedure—the legislative process.

²³ See, for example, *The Federal Revenue System: Facts and Problems 1959*, Materials Assembled by the Committee Staff for the Joint Economic Committee, Congress of the United States, Joint Committee Print, 86th Congress, 1st Session, pages 45-66, 67-82; *Tax Revision Compendium*, Committee on Ways and Means, November 16, 1959, pages 793-931, 1193-1299.

²⁴ These include the examination of proposals for statutory action in the precise area here involved:

"Short lived property may well need specific statutory treatment to distinguish 'service life,' 'economic life,' salvage or sales proceeds, etc. Cf. *The Hertz Corp. v. United States*, 165 F. Supp. 261 (D. Del. 1958), appeal pending; *Evans v. Commissioner*, 59-1 USTC ¶ 9208, 3 AFTR 2d ¶ 59-415 (9th Cir. 1959)."

(American Bar Association, Section of Taxation, 1959, Program and Committee Reports to be Presented at the Twentieth Annual Meeting of the Section to be held August 20-25, 1959, Miami, Florida, Report of the Committee on Depreciation and Amortization, page 38, footnote 14.)

A Treasury regulation is proper if it implements the law or if it explains or clarifies its meaning or if it facilitates its administration. But a regulatory provision is improper and invalid if, in the guise of any such purpose, it contradicts the clear intention of Congress. When the Treasury issues a regulation to the effect that depreciation is not allowable with respect to good will (Regulations 111, Sec. 29.23(1)-3), the regulation is valid and enforceable despite the fact that the statute does not itself except good will from the coverage of the statute. Congress was not trying to encourage the write-off of good will so that the taxpayer might go out and buy more good will. The provision on good will is thus consistent with Congressional intention.

But the new "useful life" and "salvage value" definitions asserted by the Commissioner in this case and in Reg. Sec. 1.167(a)-1(b) and (c) of the 1956 regulations (Appendix A, *infra*, pages 89-91), represent an attempt to write into the Internal Revenue Code, by administrative fiat, provisions which are in direct contravention of the clear intent and purpose of Congress, and which should therefore be declared nullities.

ADDENDUM
ON
AMERICAN AUTOMOTIVE LEASING ASSOCIATION

The Commissioner mentions the American Automotive Leasing Association's Fifth Circuit *amicus curiae* brief²⁵ in *Hillard*, 31 T.C. 961 (1959), now *sub judice* in the Fifth Circuit (Brief for the Petitioner, pages 9-10, 30-35).

(1) We are unaware of any support, in the record or otherwise, for the Commissioner's allegation that the Leasing Association comprises or speaks for "an important segment of the automobile leasing industry" (brief, pages 9, 30).

(2) The Government's filing and service of the Association's brief in the proceeding at bar appears to be an attempt at a rather informal *amicus curiae* intervention in this Court, in violation of the Court's Rule 42.

(3) Without knowing in some detail the Leasing Association members' operating methods, tax practices and possible agreements on depreciation with the Internal Revenue Service, we feel constrained to withhold extended comment either on the merits of the arguments advanced

²⁵ Although the Commissioner apparently assumes that the Association's brief was "filed," the only occurrence in that connection of which we are aware is the Association's filing on October 5, 1959, of a motion for leave to file the brief. The Clerk of the Fifth Circuit has advised us that the court has taken no action on this motion.

by the Association or on the vehemence with which they are expressed.

(4) If the Association's brief is properly before this Court at all, it should be pointed out that the entire legislative history of the basic depreciation provision of the 1939 Code and prior revenue acts, and the long-standing interpretation of the terms "useful life" and "salvage value," the cases, the administrative practice, the Commissioner's own pronouncements, expert opinion, and practice in the accounting profession—all are ignored. In fact, all considerations of any kind are subordinated to one private objective of the American Automotive Leasing Association: Overcome the Commissioner's contention in *Hillard* that the vehicles in question in that case constituted property held primarily for sale to customers in the ordinary course of the taxpayer's business. (We understand that most of the members of the Association operate automobile dealerships.)

Hillard operated a rent a car business, a used car business and an automobile finance business. There was substantial intermingling of the activities of these businesses (31 T.C. at 962, 965). Under the circumstances of that case, the question arose as to whether certain automobiles were held primarily for use in the rent a car business—and their subsequent sale merely a natural sequel thereto—or were inventory in the used car business.

The brief writer seems to have concluded that the greater the significance which can be built up around the use of the cars for rental purposes, and the more incidental the sale of the automobiles can be made to appear, the greater the chance of avoiding a decision that the automobiles are not

depreciable, and that the sale does not qualify for capital gain treatment under Section 117(j). Apparently, the brief writer decided that the safest way to prevent such a decision was to show the importance of the rent a car phase of the business and the insignificance of the car selling phase of the business by contending that the rent a car business was carried on for the entire useful life of the automobiles, and only then was it sold; and to deny, therefore, that the cars were leased "for a comparatively minor portion of their useful life", as the Tax Court had concluded. And the way to do that, it was apparently decided, was to adopt the Commissioner's definition of useful life as being the holding period. Then, says the brief writer, selling the cars is but an insignificant incident to car leasing, an activity which follows not just a minor portion of the cars' useful life, but their entire useful life—by the Commissioner's definition.

(5) Such a position forsakes the true issues in a desperate attempt to obtain an *ad hoc* result in a doubtful case, where, we note, Judge Raum found the taxpayer "evasive" and at least one of his answers "either deliberately evasive or false" (31 T.C. at 970).

(6) The Leasing Association's brief (page 43) refers to "a device or gimmick to convert ordinary income into capital gains . . ." whereas, in the light of the cases and the history of the relevant legislation, the true question is whether the Commissioner, in his zeal for maximizing the revenue, is not using "a device or gimmick" to convert proper capital gains into ordinary income.

(7) We have searched the Leasing Association's brief in vain to find any reference to the most interesting feature of the *Hillard* case: (a) The taxpayer turned over his fleet of cars every year; (b) he depreciated the cars on the basis of a three-year life; (c) the Commissioner contended that the useful life of the cars was four years.

CONCLUSION.

For the foregoing reasons, the decision of the Ninth Circuit below should be affirmed.

Respectfully submitted,

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APPENDIX A.

Treasury Regulations on Income Taxes (1954 Code):

§ 1.167(a)-1. *Depreciation in general.*—

(b) *Useful life.*—For the purpose of section 167 the estimated useful life of an asset is not necessarily the useful life inherent in the asset but is the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of his income. This period shall be determined by reference to his experience with similar property taking into account present conditions and probable future developments. Some of the factors to be considered in determining this period are (1) wear and tear and decay or decline from natural causes, (2) the normal progress of the art, economic changes, inventions, and current developments within the industry and the taxpayer's trade or business, (3) the climatic and other local conditions peculiar to the taxpayer's trade or business, and (4) the taxpayer's policy as to repairs, renewals, and replacements. Salvage value is not a factor for the purpose of determining useful life. If the taxpayer's experience is inadequate, the general experience in the industry may be used until such time as the taxpayer's own experience forms an adequate basis for making the determination. The estimated remaining useful life may be subject to modification by reason of conditions known to exist at the end of the taxable year and shall be redetermined when necessary regardless of the method of computing depreciation. However, estimated remaining useful life shall be redetermined only

when the change in the useful life is significant and there is a clear and convincing basis for the re-determination. For rules covering agreements with respect to useful life, see section 167(d) and § 1.167(d)-1.

(c) *Salvage*.—Salvage value is the amount (determined at the time of acquisition) which is estimated will be realizable upon sale or other disposition of an asset when it is no longer useful in the taxpayer's trade or business or in the production of his income and is to be retired from service by the taxpayer. Salvage value shall not be changed at any time after the determination made at the time of acquisition merely because of changes in price levels. However, if there is a redetermination of useful life under the rules of paragraph (b) of this section, salvage value may be re-determined based upon facts known at the time of such redetermination of useful life. Salvage, when reduced by the cost of removal, is referred to as net salvage. The time at which an asset is retired from service may vary according to the policy of the taxpayer. If the taxpayer's policy is to dispose of assets which are still in good operating condition, the salvage value may represent a relatively large proportion of the original basis of the asset. However, if the taxpayer customarily uses an asset until its inherent useful life has been substantially exhausted, salvage value may represent no more than junk value. Salvage value must be taken into account in determining the depreciation deduction either by a reduction of the amount subject to depreciation or by a reduction in the rate of depreciation, but in no event shall an asset (or an account) be depreciated below a reasonable salvage value. See, however, § 1.167(b)-2(a) for the treatment of salvage under the declining balance method.

The taxpayer may use either salvage or net salvage in determining depreciation allowances but such practice must be consistently followed and the treatment of the costs of removal must be consistent with the practice adopted. For specific treatment of salvage value see §§ 1.167(b)-1, 1.167(b)-2 and 1.167(b)-3. When an asset is retired or disposed of, appropriate adjustments shall be made in the asset and depreciation reserve accounts. For example, the amount of the salvage adjusted for the costs of removal may be credited to the depreciation reserve.

APPENDIX B.

TREASURY DEPARTMENT

WASHINGTON, D.C.



IMMEDIATE RELEASE

Monday, February 15, 1960

A-761

Treasury Secretary Anderson has sent the following identical letters to the Vice President and the Speaker of the House of Representatives:

February 12, 1960

My dear Mr. President:

In his Budget Message, submitted to Congress on January 18, 1960, the President recommended that consideration be given to an amendment to the Internal Revenue Code which would treat the gain from the sale of depreciable personal property as ordinary income to the extent of the depreciation deduction previously taken on the property. The enclosed draft of proposed legislation would implement the President's recommendation.

Under existing law, gain realized by a taxpayer upon the sale of depreciable personal property used in business is taxable as long-term capital gain even though part or all of the gain may be attributable to depreciation allowances which have been taken as ordinary deductions. This has hampered the sound administration of the depreciation laws because through the medium of the depreciation deduction ordinary income may be converted into capital gain. Accordingly, agents of the Internal Revenue Service have been zealous in insisting upon full proof that depreciation rates and salvage values claimed by a taxpayer can be substantiated by expert opinion or actual experience.

Informed opinion often differs as to the period of time over which an item of machinery or other depreciable property may reasonably be expected to be useful to the taxpayer in his trade or business. The necessity of establishing a salvage value for an item of personal property also causes innumerable problems for industry and the Internal Revenue Service.

The proposed statutory change which would require that gains from sale of depreciable personal property be treated as ordinary income, to the extent of depreciation previously claimed, would make it possible for agents of the Internal Revenue Service to accept more readily taxpayer judgments and taxpayer practices with respect to depreciation rates and salvage value. In short, if enacted the proposed legislation, by eliminating the opportunity which now exists of converting ordinary income into capital gains, would contribute to the sound administration of the depreciation laws.

- 2 -

It will be appreciated if you would lay the proposed legislation before the Senate. A similar proposal has been submitted to the Speaker of the House of Representatives.

Sincerely yours,

Robert B. Anderson
Secretary of the Treasury

Honorable Richard M. Nixon
President of the Senate
Washington 25, D. C.

Enclosure